

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 57		SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4		File No.* SR - 2013 - * 016 Amendment No. (req. for Amendments *)	
Filing by NASDAQ OMX BX, Inc. Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934					
Initial * <input checked="" type="checkbox"/>		Amendment * <input type="checkbox"/>		Withdrawal <input type="checkbox"/>	
Section 19(b)(2) * <input checked="" type="checkbox"/>		Section 19(b)(3)(A) * <input type="checkbox"/>		Section 19(b)(3)(B) * <input type="checkbox"/>	
Pilot <input type="checkbox"/>		Extension of Time Period for Commission Action * <input type="checkbox"/>		Date Expires * <input type="text"/>	
		Rule			
		<input type="checkbox"/> 19b-4(f)(1)		<input type="checkbox"/> 19b-4(f)(4)	
		<input type="checkbox"/> 19b-4(f)(2)		<input type="checkbox"/> 19b-4(f)(5)	
		<input type="checkbox"/> 19b-4(f)(3)		<input type="checkbox"/> 19b-4(f)(6)	
Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010			Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934		
Section 806(e)(1) <input type="checkbox"/>		Section 806(e)(2) <input type="checkbox"/>		Section 3C(b)(2) <input type="checkbox"/>	
Exhibit 2 Sent As Paper Document <input type="checkbox"/>		Exhibit 3 Sent As Paper Document <input type="checkbox"/>			
Description					
Provide a brief description of the action (limit 250 characters, required when Initial is checked *).					
<input type="text" value="A proposal for the BX Options Market to adopt a Directed Order process."/>					
Contact Information					
Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.					
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Signature					
Pursuant to the requirements of the Securities Exchange Act of 1934,					
has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.					
(Title *)					
Date 02/21/2013		Executive Vice President and General Counsel			
By Edward S. Knight		<input "="" type="text" value="Edward S Knight,"/>			
(Name *)					
NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.					

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) NASDAQ OMX BX, Inc. (“BX” or “Exchange”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² is filing with the Securities and Exchange Commission (“Commission”) a proposal for the BX Options Market (“BX Options”) to adopt a Directed Order process, as explained more fully below.

The text of the proposed rule change is set forth below. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

Chapter VI Trading Systems

* * * * *

Sec. 1 Definitions

The following definitions apply to Chapter VI for the trading of options listed on BX Options.

(a) – (d) No change.

(e) The term "Order Type" shall mean the unique processing prescribed for designated orders that are eligible for entry into the System, and shall include:

(1) [Reserved.] Directed Order. The term "Directed Order" means an order to buy or sell which has been directed (pursuant to the Exchange’s instructions on how to direct an order) to a particular Market Maker (“Directed Market Maker”) after the opening. Directed Orders are handled within the System pursuant to Chapter VI, Section 10(3).

(2) – (11) No change.

(f) – (h) No change.

* * * * *

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Sec. 6 Acceptance of Quotes and Orders

All bids or offers made and accepted on BX Options in accordance with the BX Options Rules shall constitute binding contracts, subject to applicable requirements of the Rules of the Exchange and the Rules of the Clearing Corporation.

(a) General - A System order is an order that is entered into the System for display and/or execution as appropriate. Such orders are executable against marketable contra-side orders in the System.

(1) All System Orders shall indicate whether they are a call or put and buy or sell and a price, if any. Systems Orders can be designated as Immediate or Cancel ("IOC"), Good-till-Cancelled ("GTC"), Day ("DAY") or WAIT.

(2) A System order may also be designated as a Directed Order, Limit Order, a Minimum Quantity Order, a Market Order, a Price Improving Order, an All-or-None Order or a Post-Only Order.

(b) - (c) No change.

* * * * *

Sec. 10 Book Processing

System orders shall be executed through the BX Book Process set forth below:

(1) - (2) No change.

(3) [Price Improvement - any potential price improvement resulting from an execution in the System shall accrue to the party that is removing liquidity previously posted to the Book.] Directed Order Processing.

(i) When BX's disseminated price is the NBBO and the Directed Market Maker is quoting at BX's disseminated price, the Directed Order shall be executed and allocated as follows:

(A) If the option is subject to the Price/Time execution algorithm, the Directed Market Maker shall receive 40% of the Directed Order at a particular price ("Directed Allocation"), unless such Directed Market Maker was first in time priority, in which case such Directed Market Maker shall receive the amount of the Directed Order equal to the Directed Market Maker's quote/order size at that price. If there are multiple resting quotes/orders from the same Directed Market Maker, the Directed Allocation will be distributed among them in time sequence. Then, the remainder of the Directed Order shall be allocated to other participants in price/time priority, including any remaining contracts of the Directed Market Maker and multiple quotes/orders from the same firm.

(B) If the option is subject to the Pro-Rata execution algorithm, Public Customer limit orders resting on the limit order book at the execution price will execute against the Directed Order first. Then, the Directed Market Maker shall receive the greater of: the pro-rata allocation to which such Directed Market Maker would otherwise be entitled or the Directed Allocation of 40% of the Directed Order at a particular price. If there are multiple quotes/orders from the same Directed Market Maker, the Directed Allocation will be distributed among those quotes/orders on a size pro rata basis. Once the Directed Allocation is determined, any remaining contracts associated with the Directed Market Maker's quotes/orders are excluded from the remaining pro-rata allocation. If there are any remaining contracts of the Directed Order, they will be allocated on a size pro rata basis among the remaining Participants (except the Directed Market Maker).

(ii) When BX's disseminated price is the NBBO, and the quotation disseminated by the Directed Market Maker on the opposite side of the market from the Directed Order is inferior to the NBBO, the Directed Order shall be automatically executed and allocated to those quotations and orders at the NBBO in accordance with this Section.

(iii) If BX's disseminated price is not the NBBO, the Directed Order shall be processed in accordance with Chapter VI, Sections 7, 10 and 11.

(iv) In addition, the following will apply:

- (A) A Directed Market Maker shall not be entitled to receive a number of contracts that is greater than the size associated with their order or quote at a particular price level.
- (B) Directed Allocations are rounded up to the next whole number.
- (C) The Directed Allocation is available for the life of the order and the Directed Market Maker is entitled to the Directed Allocation at all price levels that the Directed Market Maker has an order or quote.
- (D) Directed Market Makers are subject to the quoting requirements of Chapter VII, Section 6(d)(i)(4).
- (E) The Exchange will determine which options are subject to Directed Allocation.

(4) - (7) No change.

(8) Price Improvement - any potential price improvement resulting from an execution in the System shall accrue to the party that is removing liquidity previously posted to the Book.

* * * * *

Chapter VII Market Participants

* * * * *

Sec. 6 Market Maker Quotations

(a) – (c) No change.

(d) *Continuous Quotes*. A Market Maker must enter continuous bids and offers for the options to which it is registered, as follows:

i. On a daily basis, a Market Maker must during regular market hours make markets consistent with the applicable quoting requirements specified in these rules, on a continuous basis [in at least sixty percent (60%) of the series] in options in which the Market Maker is registered.

1) To satisfy this requirement [with respect to quoting a series], a Market Maker must quote[such series] 60[90]% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 60[90]% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances. This obligation will apply to all of a Market Maker's registered options collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis.

2) Notwithstanding the foregoing, Market Makers shall not be required to make two-sided markets pursuant to Section 5(a)(i) of these rules in any Quarterly Option Series, any adjusted option series, and any option series until the time to expiration for such series is less than nine months. Accordingly, the continuous quotation obligations set forth in this rule shall not apply to Market Makers respecting Quarterly Option Series, adjusted option series, and series with an expiration of nine months or greater. For purposes of this subsection (2), an adjusted option series is an option series wherein one option contract in the series represents the delivery of other than 100 shares of underlying stock or Exchange-Traded Fund Shares.

3) If a technical failure or limitation of a system of BX prevents a Market Maker from maintaining, or prevents a Market Maker from communicating to BX Options timely and accurate quotes, the duration of such failure or limitation shall not be included in any of the calculations under this subparagraph (i) with respect to the affected quotes.

4) In options in which it receives Directed Orders, a Directed Market Maker must quote such options 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance, applied collectively to all series in all of the options in which the Directed Market Maker receives Directed Orders (rather than on an option-by-option basis). Compliance with this obligation will be determined on a monthly basis.

ii. - iii. No change.

(e) No change.

* * * * *

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors on January 9, 2013. No other action is necessary for the filing of the rule change. Questions and comments on the proposed rule change may be directed to Edith Hallahan at 215-496-5179.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a. Purpose

The BX Options market launched on June 29, 2012 as a fully automated, price/time priority execution system built on the core functionality of the NASDAQ Options Market (“NOM”).³ BX Options operates as an all-electronic system (“System”) with no physical trading floor and provides for the electronic display and execution of orders. In its proposed rule change to create the BX Options market, BX stated that, initially, BX Options would have the same market structure and rules as NOM, focusing

³ See BX Options Rules, Chapter VI, Section 1(e)(11). Securities Exchange Act Release No. 67256 (June 26, 2012), 77 FR 39277 (July 2, 2012) (SR-BX-2012-030) (Approving the establishment of the BX Options market).

on a price/time priority market.⁴ BX further stated that, over time, as the BX Options market secured more participants, it would introduce additional, innovative functionality.⁵ Accordingly, BX recently introduced a Size Pro-Rata execution algorithm for BX Options,⁶ which executes orders at a particular price level based on the size of each Participant's quote or order as a percentage of the total size of all orders and quotes resting at that price. BX intends for some options to employ one algorithm while others employ a different one.

At this time, BX proposes its next enhancement to BX Options by offering a directed order process.⁷ BX proposes to amend various rules to establish the process. First, BX proposes to define a Directed Order in Chapter VI, Section 1(e)(1) as an order to buy or sell which has been directed (pursuant to the Exchange's instructions on how to direct an order) to a particular Market Maker ("Directed Market Maker") after the opening.⁸ It further provides that Directed Orders are handled within the System pursuant to Chapter VI, Section 10(3), which is proposed new language.⁹

⁴ See id. at 39278.

⁵ Securities Exchange Act Release No. 66983 (May 14, 2012), 77 FR 29730 (May 18, 2012) (Notice of filing of SR-BX-2012-030).

⁶ Securities Exchange Act Release No. 68041 (October 11, 2012), 77 FR 63903 (October 17, 2012)(SR-BX-2012-065).

⁷ The term directed order has a different meaning on equities markets. See e.g., NASDAQ Rule 4751(a)(9).

⁸ BX also proposes to amend Chapter VI, Section 6(a)(2) to add Directed Orders to the list of System orders.

⁹ Currently, Section 10(3) governs price improvement. It is being moved to new Section 10(8).

Pursuant to proposed Chapter VI, Section 10(3)(i), when BX's disseminated price is the National Best Bid/Offer ("NBBO") and the Directed Market Maker is quoting at BX's disseminated price, the Directed Order shall be executed and allocated pursuant to one of BX's two execution algorithms for options.¹⁰ If the option is subject to the Price/Time execution algorithm,¹¹ the Directed Market Maker shall receive 40% of the Directed Order ("Directed Allocation"), unless such Directed Market Maker was first in time priority, in which case such Directed Market Maker shall receive the amount of the Directed Order equal to the Directed Market Maker's quote/order size at that price. If there are multiple resting quotes/orders from the same Directed Market Maker, the Directed Allocation will be distributed among them in time sequence. Then, the remainder of the Directed Order shall be allocated to other participants in price/time priority, including any remaining contracts of the Directed Market Maker and multiple quotes/orders from the same firm.¹²

Example 1 (Price/Time)

NBBO: \$1.00 x \$1.05

BX Options Book¹³

Firm1 Order A Sell 20 at \$1.05
Firm2 Order B Sell 20 at \$1.05
MM3 Quote C \$1.00 x \$1.05 (size 100 x 100)

¹⁰ Chapter VI, Section 10(1).

¹¹ Chapter VI, Section 10(1)(A).

¹² The BX Options trading system identifies Directed Market Makers by a particular code called an IFI, which BX will use to consider which quotes/orders are from the same firm.

¹³ In each example, quotes and orders are listed in the sequence in which they were received.

Firm4 Order D Sell 50 at \$1.05

BX Options Best Offer: 190 at \$1.05

BX receives a Directed Order to buy 100 contracts at \$1.05 directed to MM3:

40 contracts execute against MM3 Quote C as a Directed Allocation: 40% of 100 contracts

20 contracts execute against Firm1 Order A based on time priority

20 contracts execute against Firm2 Order B based on time priority

20 additional contracts execute against MM3 Quote C based on time priority

The Directed Order is fully executed

No contracts execute against Firm4 because it is behind Firm1, Firm2, and MM3 in time priority and no more contracts remain

BX notes that, in this example, MM3 receives additional contracts beyond the Directed Allocation under the proposed rule, which permits the Directed Market Maker to retain its position in time priority for the remainder of the contracts. BX believes that it is reasonable and encourages Directed Market Makers to display their entire size, which benefits the quality of BX's market.

BX further notes that if a Public Customer order is involved, the Directed Allocation is nevertheless available to the Directed Participant, before the Public Customer order is executed. For example:

Example 1A (Price/Time with a Public Customer)

NBBO: \$1.00 x \$1.05

BX Options Book

Firm1 Public Customer Order A Sell 20 at \$1.05

Firm2 Broker Dealer Order B Sell 20 at \$1.05

MM3 Quote C \$1.00 x \$1.05 (size 100 x 100)

Firm4 Broker Dealer Order D Sell 50 at \$1.05

BX Options Best Offer: 190 at \$1.05

BX receives a Directed Order to buy 100 contracts at \$1.05 directed to MM3:

40 contracts execute against MM3 Quote C as a Directed Allocation: 40% of 100 contracts
20 contracts execute against Firm1 Public Customer Order A based on time priority
20 contracts execute against Firm2 Order B based on time priority
20 additional contracts execute against MM3 Quote C based on time priority
The Directed Order is fully executed
No contracts execute against Firm4 because it is behind Firm1, Firm2, and MM3 in time priority and no more contracts remain

BX is proposing to afford a Directed Allocation when there is a Public Customer order eligible to trade with the Directed Order. BX understands that other options exchanges' rules respecting directed orders do not provide a directed allocation to a directed market maker when there is a customer order ahead of a directed market maker at a particular price.¹⁴ However, BX believes it is reasonable and consistent with applicable statutory standards for the Directed Allocation to occur, as proposed herein. The Public Customer order is not precluded from participating in the trade, but rather continues to stand in time priority once the Directed Allocation occurs. The Public Customer may not receive a full execution, but had the Directed Order not been sent to BX, the Public Customer may not have received an execution at all. The Directed Participant and their relationship with the provider of that Directed Order may have attracted the order to BX, to the benefit of the Public Customer order as well as all potential contra-side orders on the book. Accordingly, there is no particular reason for a Directed Allocation to operate differently just because a Public Customer order is involved; the very nature of the price/time priority model is that Public Customer orders

¹⁴ For example, the directed order is allocated pursuant to the price/time priority rule on NYSE Arca. See NYSE Arca Rule 6.76A(a)(1)(A)(ii).

are like all other orders and do not jump ahead in priority. BX does not believe that this is unfair to Public Customer orders; it is merely a different model.

New Section 10(3)(i)(B) provides that if the option is subject to the Size Pro-Rata execution algorithm,¹⁵ Public Customer limit orders resting on the limit order book at the execution price will execute against the Directed Order first. Then, the Directed Market Maker shall receive the greater of: the pro-rata allocation to which such Directed Market Maker would otherwise be entitled pursuant to the Size Pro-Rata execution algorithm or the Directed Allocation of 40% of the Directed Order. If there are multiple resting quotes/orders from the same Directed Market Maker, the Directed Allocation will be allocated among those quotes/orders on a size pro-rata basis. Once the Directed Allocation is determined, any remaining contracts associated with the Directed Market Maker's quotes/orders are excluded from the remaining pro-rata allocation. If there are any remaining contracts of the Directed Order, they will be allocated on a size pro-rata basis among the remaining Participants (except the Directed Market Maker). For example:

Example 2 (Pro-Rata)

NBBO: \$1.00 x \$1.05

BX Options Book

Firm1 Public Customer Order A Sell 20 at \$1.05
MM2 Quote B \$1.00 x \$1.05 (size 100 x 100)
MM3 Quote C \$1.00 x \$1.05 (size 50 x 50)
MM4 Quote D \$1.00 x \$1.05 (size 100 x 100)

BX Options Best Offer: 270 at \$1.05

¹⁵ Chapter VI, Section 10(1)(B).

BX receives a Directed Order to buy 100 contracts at \$1.05 directed to MM3:

20 contracts execute against Firm1 Public Customer Order A due to Public Customer priority
 40 contracts execute against MM3 Quote C as a Directed Allocation (40% of 100 contract buy order)
 MM2 and MM4 each receive 20 contracts on a size pro-rata basis (50% each of 40 remaining contracts)

New Section 10(3)(ii) deals with the situation where BX's disseminated price is the NBBO but the quotation disseminated by the Directed Market Maker on the opposite side of the market from the Directed Order is inferior to the NBBO. In such case, the Directed Order shall be automatically executed and allocated to those quotations and orders at the NBBO in accordance with this Section as follows:

Example 3 (Price/Time or Pro-Rata – same outcome)

NBBO: \$1.00 x \$1.05

BX Options Book

Firm1 Order A Sell 100 at \$1.05
 MM2 Quote C \$1.00 x \$1.06 (size 100 x 100)

BX Options Best Offer: 100 at \$1.05

BX receives a Directed Order to buy 50 contracts directed to MM2:

50 contracts execute against Firm1 Order A
 The Directed Order is completely filled
 MM2 does not receive a Directed Allocation because Quote C is not part of BX Options' best offer nor the NBBO

New Section 10(3)(iii) covers the situation where BX's disseminated price is not the NBBO; then, the Directed Order shall be processed in accordance with Chapter VI, Sections 7, 10 and 11.

Example 4 (Price/Time or Pro-Rata – same outcome)

CBOE Quote: \$1.00 x \$1.05 (size 10 x 10)

BX Options Book

MM1 Quote A \$1.00 x \$1.06 (size 100 x 100)

MM2 Quote B \$1.00 x \$1.06 (size 50 x 50)

BX Options Best Offer: 150 at \$1.06

NBBO: \$1.00 x \$1.05 (size 160 x 10)

BX receives a Directed Order to buy 110 contracts at \$1.06 directed to MM2:

10 contracts are routed and executed against the better away offer of \$1.05 (CBOE)

Because the CBOE offer is executed, BX Options is now the NBBO
40 contracts execute against MM2 Quote B as a Directed Allocation (40% of 100 contracts remaining from the Directed Order)
60 contracts execute against MM1 Quote A

In this example, BX was not initially at the NBBO, but once the National Best Offer (“NBO”) was exhausted, BX’s offer of 150 contracts at \$1.06 became the NBO. BX proposes to permit the Directed Allocation at the next price level, even though the Directed Participant was not at the NBBO at the time of order receipt, as described further below. BX understands that other options exchanges’ directed order programs limit directed allocations to situations where the directed party is at the NBBO at the time of receipt of the directed order. BX believes that it is consistent with the purpose of the NBBO requirement to structure its Directed Order program as proposed herein for the following reasons.

The purpose of the requirement for the directed participant to be at the NBBO is to encourage such participant to quote competitively rather than to quote a wide market and wait for directed orders to arrive. BX believes that permitting the Directed Market Maker

to receive a Directed Allocation even if such market maker was not on the NBBO at the time of receipt of the Directed Order still encourages competitive quoting. The Directed Order will trade at the NBBO at the time it was received with whatever contracts are available. If, and only if, contracts remain, then the order can execute at the next price level. At that next price level that is the new NBBO, the Directed Market Maker must be on the NBBO. Under the proposal, such market maker is being rewarded for being at the next best price, consistent with the purposes of the NBBO requirement. The market maker has an incentive to quote competitively because quoting a tick or two away from the NBBO is likely to result in very little trading for that market maker, especially if other quotes and orders are at or closer to the NBBO and especially in more liquid options.

Providing market makers with an enhanced allocation for order flow that is specifically directed to that market maker when the market maker is not initially on the NBBO is fair and does not create incentives to avoid quoting at the NBBO. There is fierce competition within the BX Options market and within the broader options market place. Within the BX Options market, there are many market makers who compete for available order flow on the basis of their quoted price. If a market maker's price is not equal to or better than all other quoted prices, they will simply not trade until all other market makers (and all other participants) trade at the superior price. This creates and supports healthy competition among market makers to quote the best price possible. In addition to the competition among market makers, there are also other market participants (broker-dealer, Public Customer, professional, etc.) who compete against each other and against market makers based on price, thus providing a further incentive

for market makers to provide the best price possible. Finally, in the broader options marketplace, BX Options market makers not only have to compete with the market makers and participants on the BX Options market, but also with the plethora of market makers and other participants who quote or post orders on options exchanges other than BX Options. Indeed, the incentive to provide a competitive quote is strong due to the inherently competitive nature of today's options markets. Necessarily, a market maker who does not match or improve the NBBO on a consistent basis does not trade often. This proposal does not create a disincentive for a market maker to match or improve the NBBO. BX believes that this is an issue of timing of the directed allocation and not whether it is appropriate to afford a directed allocation at the next price level.

Providing directed order functionality should also add an additional layer of competition among those market makers who attempt to attract directed order flow. When market makers approach order flow providers to send directed order flow, the order flow providers expect clear data as evidence that directing order flow to the market maker will benefit the order flow provider and more importantly the order flow provider's customers. As more market makers attempt to attract order flow, they will likely need to show ever improving quote statistics. If a market maker were to quote \$0.01 outside the NBBO in hopes of capturing some miniscule amount of order flow at a better price than everyone else, the order flow provider would see this in their quality of execution statistics and simply stop directing order flow to the market maker. Here again, there is a strong incentive to be matching or improving the NBBO in order to attract order flow and trade.

BX notes that at the time of the approval of the first directed order programs, routing among the options exchanges occurred through a central linkage process and executions through multiple price levels were not as seamless and efficient as today. In the current environment, executions occur across multiple price levels with simultaneous outbound routing. BX believes that order execution should not be inhibited by the artificial constraint of limiting directed allocations to directed participants who are on the NBBO at the time of order receipt in an options marketplace with vigorous competition and actively changing markets. It is sufficient for the directed participant to be on the NBBO at the time of execution.

New Section 10(3)(iv) incorporates several additional provisions respecting the Directed Order process. Specifically, a Directed Market Maker shall not be entitled to receive a number of contracts that is greater than the size associated with their order or quote at a particular price level. This provision is common in other options exchanges' directed order programs and is intended to incent Directed Market Makers to show more size. Much like a market maker has an incentive to match or improve the NBBO in order to trade more often, a market maker also has the incentive to display as much liquidity as possible in order to trade more volume. The resulting additional size at the NBBO benefits investors by making the market more liquid, which, in turn, makes it easier for investors to enter and exit their specific options positions.

In addition, Directed Allocations are rounded up to the next whole number.

Example 5 (Price/Time or Pro-Rata – same outcome)

NBBO: \$1.00 x \$1.05

BX Options Book

MM1 Quote A \$1.00 x \$1.05 (size 100 x 100)

MM2 Quote B \$1.00 x \$1.05 (size 50 x 50)

BX Options Best Offer: 150 at \$1.05

BX receives a Directed Order to buy 91 contracts at \$1.05 directed to MM2:

37 contracts execute against MM2 Quote B as a Directed Allocation (40% of 91 = 36.4 rounded up to 37)

54 contracts execute against MM1 Quote A

BX understands that the directed order programs of other options exchanges have generally limited the amount of the directed allocation to 40% of the size of the directed order, which is what BX has proposed herein. Because BX intends to round that allocation up to the nearest whole number, BX acknowledges that it is mathematically possible for its proposed Directed Allocation to exceed 40% in certain situations, but, of course, because it is rounding to the nearest whole number, rounding will necessarily never result in more than one additional options contract being added to the Directed Allocation. Even if such one additional contract caused the Directed Allocation to exceed 40%, BX believes that this is appropriate and reasonable because it is only one contract, regardless of the percentage.¹⁶ Other options entitlement programs approved by the Commission sometimes exceed a 40% guarantee, also in limited, mathematically-driven situations. For example, the specialist or lead market maker entitlement permits the allocation of five contracts and less to a particular participant, which is much greater than the one contract proposed herein (i.e. the specialist entitlement allows for a 100%

¹⁶ Generally, the larger the number of contracts being rounded, the smaller the percentage, with some mathematical variation. For example, an order of 9 contracts would round up from 3.6 to 4 contracts or 44.44% of the order, whereas an order for 91 contracts would be rounded up for directed allocation purposes from 36.4 to 37 contracts or 40.66% of the order.

allocation for orders of 5 contracts or less).¹⁷ Furthermore, specialist entitlement programs also provide for a 60% allocation in situations where the split is between two participants. Furthermore, pursuant to proposed subparagraph (iv)(C), the Directed Allocation is available for the life of the order. If a Directed Order is not executed upon receipt, it retains its status as a Directed Order, such that, once it becomes executable, it is subject to Directed Order Handling under new Section 10(3).

Example 6 (Price/Time or Pro-Rata – same outcome)

CBOE Quote: \$1.00 x \$1.05 (size 10 x 10)

NBBO: \$1.00 x \$1.05 (size 160 x 10)

BX Options Book

MM1 Quote A \$1.00 x \$1.06 (size 100 x 100)

MM2 Quote B \$1.00 x \$1.06 (size 50 x 50)

BX Options Best Offer: 150 at \$1.06

BX receives a non-routable Directed Order to buy 100 contracts at \$1.06 directed to MM2:

The order is posted on the BX Options book at \$1.05 and displayed at \$1.04¹⁸

CBOE updates its quote to \$1.00 x \$1.07 (size 10 x 10)

The new NBBO is \$1.00 x \$1.06 (size 160 x 150)

The Directed Order can now execute against the BX Options book at \$1.06 as follows:

40 contracts execute against MM2 Quote B as a Directed Allocation (40% of the 100 contract buy order)

¹⁷ The specialist on NYSE MKT receives a 100% allocation on orders of 5 contracts or less and 40% of other eligible orders, even though the specialist's quoting obligation is the same as the proposed BX Options Directed Market Maker quoting obligation.

¹⁸ See Chapter VI, Section 11.

60 contracts execute against MM1 Quote A

The Exchange believes that it is useful and beneficial for the order to retain its status as a Directed Order, because this handling is consistent with the order instructions and original intent of the submitting Participant. On other options exchanges, the “directed order” designation is only considered upon receipt of the order.¹⁹ BX believes that its Participants may find this feature attractive; otherwise, Participants might consider cancelling and re-entering the order so it is treated as a Directed Order, which would be less efficient and would increase message traffic. BX does not believe that retaining directed order status on the book is controversial or inconsistent with the Act. Nor does BX believe that it undermines the policy underpinnings of directed order programs. Rather, it is an innovative enhancement intended to make entering directed orders more efficient and modern. It is possible that more directed allocations will occur because orders retain their directed order status, but the same result could be achieved today by, inefficiently, reentering directed orders rather than leaving them on the book as non-directed orders.

In addition, the Directed Market Maker is entitled to the Directed Allocation at all price levels at which the Directed Market Maker has an order or quote. This is intended to reflect that orders are executable at multiple price levels, and that, today, market makers can enter orders at multiple price levels.

¹⁹ See e.g., Phlx Rule 1080(l)(ii), which provides: When the Exchange's disseminated price is the NBBO *at the time of receipt* of the Directed Order, and the Directed Specialist, SQT or RSQT is quoting at the Exchange's disseminated price, the Directed Order shall be automatically executed and allocated in accordance with Rule 1014(g)(viii).

Example 7 (Price/Time or Pro-Rata – same outcome)

NBBO: \$1.00 x \$1.05

BX Options Book

MM1 Quote A \$1.00 x \$1.05 (size 20 x 20)
MM2 Quote B \$1.00 x \$1.05 (size 10 x 10)
MM3 Quote C \$1.00 x \$1.06 (size 100 x 100)
MM2 Quote D \$1.00 x \$1.06 (size 50 x 50)

BX Options Best Offer: 30 at \$1.05

BX receives a Directed Order to buy 110 contracts at \$1.06 directed to MM2:

20 contracts execute against MM1 Quote A
10 contracts execute against MM2 Quote B
\$1.05 price level is completely exhausted
32 contracts execute against MM2 Quote D as a Directed Allocation (40% of 80 remaining contracts from buy order)
48 contracts execute against MM3 Quote C

New Quoting Requirement for All Market Makers

BX also proposes to change the quoting obligation applicable to its Market Makers. Currently, Chapter VII, Section 6(d) provides that on a daily basis, a Market Maker must during regular market hours make markets consistent with the applicable quoting requirements specified in these rules, on a continuous basis in at least sixty percent (60%) of the series in options in which the Market Maker is registered. It further provides that, to satisfy this requirement with respect to quoting a series, a Market Maker must quote such series 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 90% (or higher) of the trading day

based on demonstrated legal or regulatory requirements or other mitigating circumstances.

BX proposes to better align its market maker quoting requirement with that of other exchanges, such as NYSE Arca and NYSE MKT. Specifically, BX proposes to reduce the quoting requirement for non-Directed BX Options Market Makers as follows: a Market Maker must quote such options 60% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 60% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances. This obligation will apply to all of a Market Maker's registered options collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis. This is the same requirement as on other options exchanges.²⁰

BX believes that this is appropriate for two reasons. First, BX's current Market Maker quoting requirement is much more stringent than certain other exchanges. Quoting *each series* 90% of the trading day is much more stringent than looking at all options in which a Market Maker is registered, because it allows for some number of series not to be quoted at all, as long as the overall standard is met. This better accommodates the occasional issues that may arise in a particular series, whether technical or manual. The existing requirement may at times discourage liquidity in particular options series because a market maker is forced to focus on a momentary lapse rather than using the appropriate resources to focus on the options series that need and consume additional

²⁰ See NYSE Arca Rule 6.88 and NYSE MKT Rule 964.1NY.

liquidity. As a new market, BX believes that it can better attract Market Makers to the BX Options market and grow its market if its quoting obligation is more in line with that of other exchanges. In addition, as BX seeks to introduce directed orders, the market maker quoting obligation has become an obstacle to crafting a competitive, attractive directed order program. Specifically, because the Commission has required directed participants to be subject to heightened quoting obligations as compared to non-directed market makers, BX would have to adopt a Directed Market Maker quoting obligation more stringent than the current 90% of the time/60% of the series requirement for regular BX Options Market Makers. BX does not believe that a quoting requirement for greater than 90% of the time would attract Directed Market Makers to BX Options, as BX embarks on growing its market with new functionality and features. In fact, a more stringent quoting requirement would likely discourage new market makers from participating in the BX Options market and inhibit current market makers' ability to provide liquidity effectively.

New Quoting Requirement for Directed Market Makers

New Section 10(3)(iv)(D) makes clear that Directed Market Makers are subject to the quoting requirements of new Chapter VII, Section 6(d)(iv). Specifically, in options in which it receives Directed Orders, a Directed Market Maker must quote 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 90% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances. This obligation will apply collectively to all series in all of the options in which the Directed

Market Maker receives Directed Orders, rather than on an option-by-option basis.

Compliance with this obligation will be determined on a monthly basis. This quoting obligation is more stringent than that which is applicable to regular BX Options Market Makers, who will now have to quote, under this proposal, at least 60% of the time the Exchange is open for trading in registered options. Such quotations must meet the quote width requirements of Chapter VII, Section 6(d)(ii). Once a Directed Market Maker receives a Directed Order, the heightened quoting obligation is triggered and applies to the options in which the Directed Market Maker receives Directed Orders.

Lastly, Section 10(3)(iv)(E) will provide that the Exchange will determine which options have the Directed Allocation functionality available.²¹ BX will issue an Options Trader Alert to inform its Participants in which options the Directed Allocation will be available.

Conclusion

In summary, BX seeks to compete with the many options exchanges that offer directed orders in their respective markets and seeks to introduce directed order functionality, as described above.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act²² in general, and furthers the objectives of Section 6(b)(5) of the Act²³ in particular,

²¹ Directed Orders received in options where BX Options is not offering Directed Order processing will not be rejected; instead, such orders will be handled normally as non-Directed Orders.

²² 15 U.S.C. 78f(b).

²³ 15 U.S.C. 78f(b)(5).

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 mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest, because it will establish a directed order process similar to what operates on other exchanges, as explained in detail herein, which will provide Participants with additional choices among the many competing exchanges with regard to their execution needs and strategies. BX Options operates in an intensely competitive environment and seeks to offer the same services that its competitors offer and in which its customers find value.

In its approval of other options exchange directed order programs, the Commission has, like proposals to amend a specialist guarantee, focused on whether the percentage of the “entitlement” would rise to a level that could have a material adverse impact on quote competition within a particular exchange, and concluded that such programs do not jeopardize market integrity or the incentive for market participants to post competitive quotes.²⁴ BX’s proposed Directed Allocation of 40% is consistent with the directed order allocations of other options exchanges, except for the impact of rounding up, as described above, which BX does not believe is significant. BX notes that the remaining portion of each order will still be allocated based on the competitive bidding of market participants. In addition, at the time of execution, a BX Options Directed Market Maker will have to be quoting at the NBBO for the size of the Directed Allocation to receive the Directed Allocation, which is intended to incent the Directed

²⁴ See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (SR-Phlx-2004-91).

Market Maker to quote aggressively, because he cannot merely step up and match the NBBO after the Directed Order is received. Similarly, BX believes there is an incentive for Directed Market Makers to quote competitively even though they may receive a Directed Allocation when such Directed Market Maker is not on the NBBO at the time of order receipt, but is at the time of execution. BX also notes that BX Options Directed Market Makers will have greater quoting obligations than other BX Options Market Makers.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The competition among the options exchanges is vigorous and this proposal is intended to afford the BX Options market the opportunity to compete for directed order flow. In that regard, the proposal is pro-competitive and will offer market participants an additional venue for the execution of directed orders. The Exchange does not believe that the proposal imposes a burden on intra-market competition not necessary or appropriate in furtherance of the purposes of the Act, because the ability to send directed orders is available to all Participants, and the ability to become a Market Maker is available to all Market Makers.

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

No written comments were either solicited or received.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposal is substantially similar to NYSE Arca Rule 6.88 and NYSE MKT Rule 964.1NY, except that under proposed Chapter VI, Section 10(3)(iv)(C) the Directed Allocation is available for the life of the order and not just at the time of receipt,²⁵ as described above. BX does not believe that this is a significant difference, because Participants could achieve the same result by cancelling and re-entering a Directed Order. This is cumbersome and inefficient, and would increase message traffic. Thus, BX believes that its Participants might find this to be an attractive feature. In addition, the rule will be clear that this is how Directed Orders will be handled. The definition of a directed order on NYSE Arca and NYSE MKT provides that it is limited to “marketable” orders, which is consistent with the “at the time of receipt” language in the directed order rules of those exchanges, and thus implies that directed orders do not go on the book. As proposed herein, Directed Orders can go on the BX Options book. The definition of directed order also differs from BX’s proposed definition in that the directed order must come from an Order Flow Provider,²⁶ while, on BX, any Participant can submit a Directed Order. BX does not believe that this is a significant difference, because it permits *more* rather than fewer types of directed orders and BX expects that most

²⁵ See NYSE Arca Rule 6.88 and NYSE MKT Rule 964.1NY.

²⁶ See NYSE Arca Rule 6.1A(a)(21), which is essentially the same as the definition of Order Entry Firm in BX Options Rules, Chapter VII, Section 1.

Directed Orders will be submitted by Order Flow Providers.²⁷ In addition, the BX Options Directed Market Maker must be on the NBBO at the time of the execution of the Directed Order, rather than at the time of receipt. Nevertheless, BX believes that the proposal is consistent with the purpose of this NBBO requirement, as discussed above.

With respect to the additional quoting obligations applicable to Directed Market Makers, the proposal is similar to NYSE Arca Rule 6.88 and NYSE MKT Rule 964.1NY. In addition, the new quoting requirement for regular Market Makers is the same as that of NYSE Arca and NYSE MKT as well.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advanced Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of proposed rule for publication in the Federal Register.

²⁷ See BX Options Rules, Chapter I, Section 1.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-BX-2013-016)

February __, 2013

Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing of Proposed Rule Change to Adopt a Directed Order Process

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 21, 2013, NASDAQ OMX BX, Inc. (“BX” 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 Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange has filed a proposed rule change offering a new enhancement to adopt a Direct Order process.

The text of the proposed rule change is below. Proposed new language is underlined.

* * * * *

Chapter VI Trading Systems

* * * * *

Sec. 1 Definitions

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The following definitions apply to Chapter VI for the trading of options listed on BX Options.

(a) – (d) No change.

(e) The term "Order Type" shall mean the unique processing prescribed for designated orders that are eligible for entry into the System, and shall include:

(1) [Reserved.] Directed Order. The term "Directed Order" means an order to buy or sell which has been directed (pursuant to the Exchange's instructions on how to direct an order) to a particular Market Maker ("Directed Market Maker") after the opening. Directed Orders are handled within the System pursuant to Chapter VI, Section 10(3).

(2) – (11) No change.

(f) – (h) No change.

* * * * *

Sec. 6 Acceptance of Quotes and Orders

All bids or offers made and accepted on BX Options in accordance with the BX Options Rules shall constitute binding contracts, subject to applicable requirements of the Rules of the Exchange and the Rules of the Clearing Corporation.

(a) General - A System order is an order that is entered into the System for display and/or execution as appropriate. Such orders are executable against marketable contra-side orders in the System.

(1) All System Orders shall indicate whether they are a call or put and buy or sell and a price, if any. Systems Orders can be designated as Immediate or Cancel ("IOC"), Good-till-Cancelled ("GTC"), Day ("DAY") or WAIT.

(2) A System order may also be designated as a Directed Order, Limit Order, a Minimum Quantity Order, a Market Order, a Price Improving Order, an All-or-None Order or a Post-Only Order.

(b) - (c) No change.

* * * * *

Sec. 10 Book Processing

System orders shall be executed through the BX Book Process set forth below:

(1) - (2) No change.

(3) [Price Improvement - any potential price improvement resulting from an execution in the System shall accrue to the party that is removing liquidity previously posted to the Book.] Directed Order Processing.

(i) When BX's disseminated price is the NBBO and the Directed Market Maker is quoting at BX's disseminated price, the Directed Order shall be executed and allocated as follows:

(A) If the option is subject to the Price/Time execution algorithm, the Directed Market Maker shall receive 40% of the Directed Order at a particular price

(“Directed Allocation”), unless such Directed Market Maker was first in time priority, in which case such Directed Market Maker shall receive the amount of the Directed Order equal to the Directed Market Maker’s quote/order size at that price. If there are multiple resting quotes/orders from the same Directed Market Maker, the Directed Allocation will be distributed among them in time sequence. Then, the remainder of the Directed Order shall be allocated to other participants in price/time priority, including any remaining contracts of the Directed Market Maker and multiple quotes/orders from the same firm.

(B) If the option is subject to the Pro-Rata execution algorithm, Public Customer limit orders resting on the limit order book at the execution price will execute against the Directed Order first. Then, the Directed Market Maker shall receive the greater of: the pro-rata allocation to which such Directed Market Maker would otherwise be entitled or the Directed Allocation of 40% of the Directed Order at a particular price. If there are multiple quotes/orders from the same Directed Market Maker, the Directed Allocation will be distributed among those quotes/orders on a size pro rata basis. Once the Directed Allocation is determined, any remaining contracts associated with the Directed Market Maker’s quotes/orders are excluded from the remaining pro-rata allocation. If there are any remaining contracts of the Directed Order, they will be allocated on a size pro rata basis among the remaining Participants (except the Directed Market Maker).

(ii) When BX's disseminated price is the NBBO, and the quotation disseminated by the Directed Market Maker on the opposite side of the market from the Directed

Order is inferior to the NBBO, the Directed Order shall be automatically executed and allocated to those quotations and orders at the NBBO in accordance with this Section.

(iii) If BX's disseminated price is not the NBBO, the Directed Order shall be processed in accordance with Chapter VI, Sections 7, 10 and 11.

(iv) In addition, the following will apply:

- (A) A Directed Market Maker shall not be entitled to receive a number of contracts that is greater than the size associated with their order or quote at a particular price level.
- (B) Directed Allocations are rounded up to the next whole number.
- (C) The Directed Allocation is available for the life of the order and the Directed Market Maker is entitled to the Directed Allocation at all price levels that the Directed Market Maker has an order or quote.
- (D) Directed Market Makers are subject to the quoting requirements of Chapter VII, Section 6(d)(i)(4).
- (E) The Exchange will determine which options are subject to Directed Allocation.

(4) - (7) No change.

(8) Price Improvement - any potential price improvement resulting from an execution in the System shall accrue to the party that is removing liquidity previously posted to the Book.

* * * * *

Chapter VII Market Participants

* * * * *

Sec. 6 Market Maker Quotations

(a) – (c) No change.

(d) *Continuous Quotes.* A Market Maker must enter continuous bids and offers for the options to which it is registered, as follows:

i. On a daily basis, a Market Maker must during regular market hours make markets consistent with the applicable quoting requirements specified in these rules, on a continuous basis [in at least sixty percent (60%) of the series] in options in which the Market Maker is registered.

1) To satisfy this requirement [with respect to quoting a series], a Market Maker must quote[such series] 60[90]% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 60[90]% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other

mitigating circumstances. This obligation will apply to all of a Market Maker's registered options collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis.

2) Notwithstanding the foregoing, Market Makers shall not be required to make two-sided markets pursuant to Section 5(a)(i) of these rules in any Quarterly Option Series, any adjusted option series, and any option series until the time to expiration for such series is less than nine months. Accordingly, the continuous quotation obligations set forth in this rule shall not apply to Market Makers respecting Quarterly Option Series, adjusted option series, and series with an expiration of nine months or greater. For purposes of this subsection (2), an adjusted option series is an option series wherein one option contract in the series represents the delivery of other than 100 shares of underlying stock or Exchange-Traded Fund Shares.

3) If a technical failure or limitation of a system of BX prevents a Market Maker from maintaining, or prevents a Market Maker from communicating to BX Options timely and accurate quotes, the duration of such failure or limitation shall not be included in any of the calculations under this subparagraph (i) with respect to the affected quotes.

4) In options in which it receives Directed Orders, a Directed Market Maker must quote such options 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance, applied collectively to all series in all of the options in which the Directed Market Maker receives Directed Orders (rather than on an option-by-option basis). Compliance with this obligation will be determined on a monthly basis.

ii. - iii. No change.

(e) No change.

* * * * *

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The BX Options market launched on June 29, 2012 as a fully automated, price/time priority execution system built on the core functionality of the NASDAQ Options Market ("NOM").³ BX Options operates as an all-electronic system ("System") with no physical trading floor and provides for the electronic display and execution of orders. In its proposed rule change to create the BX Options market, BX stated that, initially, BX Options would have the same market structure and rules as NOM, focusing on a price/time priority market.⁴ BX further stated that, over time, as the BX Options

³ See BX Options Rules, Chapter VI, Section 1(e)(11). Securities Exchange Act Release No. 67256 (June 26, 2012), 77 FR 39277 (July 2, 2012) (SR-BX-2012-030) (Approving the establishment of the BX Options market).

⁴ See id. at 39278.

market secured more participants, it would introduce additional, innovative functionality.⁵ Accordingly, BX recently introduced a Size Pro-Rata execution algorithm for BX Options,⁶ which executes orders at a particular price level based on the size of each Participant's quote or order as a percentage of the total size of all orders and quotes resting at that price. BX intends for some options to employ one algorithm while others employ a different one.

At this time, BX proposes its next enhancement to BX Options by offering a directed order process.⁷ BX proposes to amend various rules to establish the process. First, BX proposes to define a Directed Order in Chapter VI, Section 1(e)(1) as an order to buy or sell which has been directed (pursuant to the Exchange's instructions on how to direct an order) to a particular Market Maker ("Directed Market Maker") after the opening.⁸ It further provides that Directed Orders are handled within the System pursuant to Chapter VI, Section 10(3), which is proposed new language.⁹

Pursuant to proposed Chapter VI, Section 10(3)(i), when BX's disseminated price is the National Best Bid/Offer ("NBBO") and the Directed Market Maker is quoting at BX's

⁵ Securities Exchange Act Release No. 66983 (May 14, 2012), 77 FR 29730 (May 18, 2012) (Notice of filing of SR-BX-2012-030).

⁶ Securities Exchange Act Release No. 68041 (October 11, 2012), 77 FR 63903 (October 17, 2012)(SR-BX-2012-065).

⁷ The term directed order has a different meaning on equities markets. See e.g., NASDAQ Rule 4751(a)(9).

⁸ BX also proposes to amend Chapter VI, Section 6(a)(2) to add Directed Orders to the list of System orders.

⁹ Currently, Section 10(3) governs price improvement. It is being moved to new Section 10(8).

disseminated price, the Directed Order shall be executed and allocated pursuant to one of BX's two execution algorithms for options.¹⁰ If the option is subject to the Price/Time execution algorithm,¹¹ the Directed Market Maker shall receive 40% of the Directed Order ("Directed Allocation"), unless such Directed Market Maker was first in time priority, in which case such Directed Market Maker shall receive the amount of the Directed Order equal to the Directed Market Maker's quote/order size at that price. If there are multiple resting quotes/orders from the same Directed Market Maker, the Directed Allocation will be distributed among them in time sequence. Then, the remainder of the Directed Order shall be allocated to other participants in price/time priority, including any remaining contracts of the Directed Market Maker and multiple quotes/orders from the same firm.¹²

Example 1 (Price/Time)

NBBO: \$1.00 x \$1.05

BX Options Book¹³

Firm1 Order A Sell 20 at \$1.05
Firm2 Order B Sell 20 at \$1.05
MM3 Quote C \$1.00 x \$1.05 (size 100 x 100)
Firm4 Order D Sell 50 at \$1.05

BX Options Best Offer: 190 at \$1.05

¹⁰ Chapter VI, Section 10(1).

¹¹ Chapter VI, Section 10(1)(A).

¹² The BX Options trading system identifies Directed Market Makers by a particular code called an IFI, which BX will use to consider which quotes/orders are from the same firm.

¹³ In each example, quotes and orders are listed in the sequence in which they were received.

BX receives a Directed Order to buy 100 contracts at \$1.05 directed to MM3:

40 contracts execute against MM3 Quote C as a Directed Allocation: 40% of 100 contracts

20 contracts execute against Firm1 Order A based on time priority

20 contracts execute against Firm2 Order B based on time priority

20 additional contracts execute against MM3 Quote C based on time priority

The Directed Order is fully executed

No contracts execute against Firm4 because it is behind Firm1, Firm2, and MM3 in time priority and no more contracts remain

BX notes that, in this example, MM3 receives additional contracts beyond the Directed Allocation under the proposed rule, which permits the Directed Market Maker to retain its position in time priority for the remainder of the contracts. BX believes that it is reasonable and encourages Directed Market Makers to display their entire size, which benefits the quality of BX's market.

BX further notes that if a Public Customer order is involved, the Directed Allocation is nevertheless available to the Directed Participant, before the Public Customer order is executed. For example:

Example 1A (Price/Time with a Public Customer)

NBBO: \$1.00 x \$1.05

BX Options Book

Firm1 Public Customer Order A Sell 20 at \$1.05

Firm2 Broker Dealer Order B Sell 20 at \$1.05

MM3 Quote C \$1.00 x \$1.05 (size 100 x 100)

Firm4 Broker Dealer Order D Sell 50 at \$1.05

BX Options Best Offer: 190 at \$1.05

BX receives a Directed Order to buy 100 contracts at \$1.05 directed to MM3:

40 contracts execute against MM3 Quote C as a Directed Allocation: 40% of 100 contracts

20 contracts execute against Firm1 Public Customer Order A based on time priority

20 contracts execute against Firm2 Order B based on time priority
20 additional contracts execute against MM3 Quote C based on time priority
The Directed Order is fully executed
No contracts execute against Firm4 because it is behind Firm1, Firm2, and MM3
in time priority and no more contracts remain

BX is proposing to afford a Directed Allocation when there is a Public Customer order eligible to trade with the Directed Order. BX understands that other options exchanges' rules respecting directed orders do not provide a directed allocation to a directed market maker when there is a customer order ahead of a directed market maker at a particular price.¹⁴ However, BX believes it is reasonable and consistent with applicable statutory standards for the Directed Allocation to occur, as proposed herein. The Public Customer order is not precluded from participating in the trade, but rather continues to stand in time priority once the Directed Allocation occurs. The Public Customer may not receive a full execution, but had the Directed Order not been sent to BX, the Public Customer may not have received an execution at all. The Directed Participant and their relationship with the provider of that Directed Order may have attracted the order to BX, to the benefit of the Public Customer order as well as all potential contra-side orders on the book. Accordingly, there is no particular reason for a Directed Allocation to operate differently just because a Public Customer order is involved; the very nature of the price/time priority model is that Public Customer orders are like all other orders and do not jump ahead in priority. BX does not believe that this is unfair to Public Customer orders; it is merely a different model.

¹⁴ For example, the directed order is allocated pursuant to the price/time priority rule on NYSE Arca. See NYSE Arca Rule 6.76A(a)(1)(A)(ii).

New Section 10(3)(i)(B) provides that if the option is subject to the Size Pro-Rata execution algorithm,¹⁵ Public Customer limit orders resting on the limit order book at the execution price will execute against the Directed Order first. Then, the Directed Market Maker shall receive the greater of: the pro-rata allocation to which such Directed Market Maker would otherwise be entitled pursuant to the Size Pro-Rata execution algorithm or the Directed Allocation of 40% of the Directed Order. If there are multiple resting quotes/orders from the same Directed Market Maker, the Directed Allocation will be allocated among those quotes/orders on a size pro-rata basis. Once the Directed Allocation is determined, any remaining contracts associated with the Directed Market Maker's quotes/orders are excluded from the remaining pro-rata allocation. If there are any remaining contracts of the Directed Order, they will be allocated on a size pro-rata basis among the remaining Participants (except the Directed Market Maker). For example:

Example 2 (Pro-Rata)

NBBO: \$1.00 x \$1.05

BX Options Book

Firm1 Public Customer Order A Sell 20 at \$1.05

MM2 Quote B \$1.00 x \$1.05 (size 100 x 100)

MM3 Quote C \$1.00 x \$1.05 (size 50 x 50)

MM4 Quote D \$1.00 x \$1.05 (size 100 x 100)

BX Options Best Offer: 270 at \$1.05

BX receives a Directed Order to buy 100 contracts at \$1.05 directed to MM3:

20 contracts execute against Firm1 Public Customer Order A due to Public Customer priority

¹⁵ Chapter VI, Section 10(1)(B).

40 contracts execute against MM3 Quote C as a Directed Allocation (40% of 100 contract buy order)
MM2 and MM4 each receive 20 contracts on a size pro-rata basis (50% each of 40 remaining contracts)

New Section 10(3)(ii) deals with the situation where BX's disseminated price is the NBBO but the quotation disseminated by the Directed Market Maker on the opposite side of the market from the Directed Order is inferior to the NBBO. In such case, the Directed Order shall be automatically executed and allocated to those quotations and orders at the NBBO in accordance with this Section as follows:

Example 3 (Price/Time or Pro-Rata – same outcome)

NBBO: \$1.00 x \$1.05

BX Options Book

Firm1 Order A Sell 100 at \$1.05
MM2 Quote C \$1.00 x \$1.06 (size 100 x 100)

BX Options Best Offer: 100 at \$1.05

BX receives a Directed Order to buy 50 contracts directed to MM2:

50 contracts execute against Firm1 Order A
The Directed Order is completely filled
MM2 does not receive a Directed Allocation because Quote C is not part of BX Options' best offer nor the NBBO

New Section 10(3)(iii) covers the situation where BX's disseminated price is not the NBBO; then, the Directed Order shall be processed in accordance with Chapter VI, Sections 7, 10 and 11.

Example 4 (Price/Time or Pro-Rata – same outcome)

CBOE Quote: \$1.00 x \$1.05 (size 10 x 10)

BX Options Book

MM1 Quote A \$1.00 x \$1.06 (size 100 x 100)

MM2 Quote B \$1.00 x \$1.06 (size 50 x 50)

BX Options Best Offer: 150 at \$1.06

NBBO: \$1.00 x \$1.05 (size 160 x 10)

BX receives a Directed Order to buy 110 contracts at \$1.06 directed to MM2:

10 contracts are routed and executed against the better away offer of \$1.05 (CBOE)

Because the CBOE offer is executed, BX Options is now the NBBO
40 contracts execute against MM2 Quote B as a Directed Allocation (40% of 100 contracts remaining from the Directed Order)
60 contracts execute against MM1 Quote A

In this example, BX was not initially at the NBBO, but once the National Best Offer (“NBO”) was exhausted, BX’s offer of 150 contracts at \$1.06 became the NBO. BX proposes to permit the Directed Allocation at the next price level, even though the Directed Participant was not at the NBBO at the time of order receipt, as described further below. BX understands that other options exchanges’ directed order programs limit directed allocations to situations where the directed party is at the NBBO at the time of receipt of the directed order. BX believes that it is consistent with the purpose of the NBBO requirement to structure its Directed Order program as proposed herein for the following reasons.

The purpose of the requirement for the directed participant to be at the NBBO is to encourage such participant to quote competitively rather than to quote a wide market and wait for directed orders to arrive. BX believes that permitting the Directed Market Maker to receive a Directed Allocation even if such market maker was not on the NBBO at the time of receipt of the Directed Order still encourages competitive quoting. The Directed Order will trade at the NBBO at the time it was received with whatever contracts are

available. If, and only if, contracts remain, then the order can execute at the next price level. At that next price level that is the new NBBO, the Directed Market Maker must be on the NBBO. Under the proposal, such market maker is being rewarded for being at the next best price, consistent with the purposes of the NBBO requirement. The market maker has an incentive to quote competitively because quoting a tick or two away from the NBBO is likely to result in very little trading for that market maker, especially if other quotes and orders are at or closer to the NBBO and especially in more liquid options.

Providing market makers with an enhanced allocation for order flow that is specifically directed to that market maker when the market maker is not initially on the NBBO is fair and does not create incentives to avoid quoting at the NBBO. There is fierce competition within the BX Options market and within the broader options market place. Within the BX Options market, there are many market makers who compete for available order flow on the basis of their quoted price. If a market maker's price is not equal to or better than all other quoted prices, they will simply not trade until all other market makers (and all other participants) trade at the superior price. This creates and supports healthy competition among market makers to quote the best price possible. In addition to the competition among market makers, there are also other market participants (broker-dealer, Public Customer, professional, etc.) who compete against each other and against market makers based on price, thus providing a further incentive for market makers to provide the best price possible. Finally, in the broader options marketplace, BX Options market makers not only have to compete with the market makers and participants on the BX Options market, but also with the plethora of market

makers and other participants who quote or post orders on options exchanges other than BX Options. Indeed, the incentive to provide a competitive quote is strong due to the inherently competitive nature of today's options markets. Necessarily, a market maker who does not match or improve the NBBO on a consistent basis does not trade often. This proposal does not create a disincentive for a market maker to match or improve the NBBO. BX believes that this is an issue of timing of the directed allocation and not whether it is appropriate to afford a directed allocation at the next price level.

Providing directed order functionality should also add an additional layer of competition among those market makers who attempt to attract directed order flow. When market makers approach order flow providers to send directed order flow, the order flow providers expect clear data as evidence that directing order flow to the market maker will benefit the order flow provider and more importantly the order flow provider's customers. As more market makers attempt to attract order flow, they will likely need to show ever improving quote statistics. If a market maker were to quote \$0.01 outside the NBBO in hopes of capturing some miniscule amount of order flow at a better price than everyone else, the order flow provider would see this in their quality of execution statistics and simply stop directing order flow to the market maker. Here again, there is a strong incentive to be matching or improving the NBBO in order to attract order flow and trade.

BX notes that at the time of the approval of the first directed order programs, routing among the options exchanges occurred through a central linkage process and executions through multiple price levels were not as seamless and efficient as today. In the current environment, executions occur across multiple price levels with simultaneous outbound

routing. BX believes that order execution should not be inhibited by the artificial constraint of limiting directed allocations to directed participants who are on the NBBO at the time of order receipt in an options marketplace with vigorous competition and actively changing markets. It is sufficient for the directed participant to be on the NBBO at the time of execution.

New Section 10(3)(iv) incorporates several additional provisions respecting the Directed Order process. Specifically, a Directed Market Maker shall not be entitled to receive a number of contracts that is greater than the size associated with their order or quote at a particular price level. This provision is common in other options exchanges' directed order programs and is intended to incent Directed Market Makers to show more size. Much like a market maker has an incentive to match or improve the NBBO in order to trade more often, a market maker also has the incentive to display as much liquidity as possible in order to trade more volume. The resulting additional size at the NBBO benefits investors by making the market more liquid, which, in turn, makes it easier for investors to enter and exit their specific options positions.

In addition, Directed Allocations are rounded up to the next whole number.

Example 5 (Price/Time or Pro-Rata – same outcome)

NBBO: \$1.00 x \$1.05

BX Options Book

MM1 Quote A \$1.00 x \$1.05 (size 100 x 100)

MM2 Quote B \$1.00 x \$1.05 (size 50 x 50)

BX Options Best Offer: 150 at \$1.05

BX receives a Directed Order to buy 91 contracts at \$1.05 directed to MM2:

37 contracts execute against MM2 Quote B as a Directed Allocation (40% of 91 = 36.4 rounded up to 37)
54 contracts execute against MM1 Quote A

BX understands that the directed order programs of other options exchanges have generally limited the amount of the directed allocation to 40% of the size of the directed order, which is what BX has proposed herein. Because BX intends to round that allocation up to the nearest whole number, BX acknowledges that it is mathematically possible for its proposed Directed Allocation to exceed 40% in certain situations, but, of course, because it is rounding to the nearest whole number, rounding will necessarily never result in more than one additional options contract being added to the Directed Allocation. Even if such one additional contract caused the Directed Allocation to exceed 40%, BX believes that this is appropriate and reasonable because it is only one contract, regardless of the percentage.¹⁶ Other options entitlement programs approved by the Commission sometimes exceed a 40% guarantee, also in limited, mathematically-driven situations. For example, the specialist or lead market maker entitlement permits the allocation of five contracts and less to a particular participant, which is much greater than the one contract proposed herein (i.e. the specialist entitlement allows for a 100% allocation for orders of 5 contracts or less).¹⁷ Furthermore, specialist entitlement programs also provide for a 60% allocation in situations where the split is between two

¹⁶ Generally, the larger the number of contracts being rounded, the smaller the percentage, with some mathematical variation. For example, an order of 9 contracts would round up from 3.6 to 4 contracts or 44.44% of the order, whereas an order for 91 contracts would be rounded up for directed allocation purposes from 36.4 to 37 contracts or 40.66% of the order.

¹⁷ The specialist on NYSE MKT receives a 100% allocation on orders of 5 contracts or less and 40% of other eligible orders, even though the specialist's quoting obligation is the same as the proposed BX Options Directed Market Maker quoting obligation.

participants. Furthermore, pursuant to proposed subparagraph (iv)(C), the Directed Allocation is available for the life of the order. If a Directed Order is not executed upon receipt, it retains its status as a Directed Order, such that, once it becomes executable, it is subject to Directed Order Handling under new Section 10(3).

Example 6 (Price/Time or Pro-Rata – same outcome)

CBOE Quote: \$1.00 x \$1.05 (size 10 x 10)

NBBO: \$1.00 x \$1.05 (size 160 x 10)

BX Options Book

MM1 Quote A \$1.00 x \$1.06 (size 100 x 100)

MM2 Quote B \$1.00 x \$1.06 (size 50 x 50)

BX Options Best Offer: 150 at \$1.06

BX receives a non-routable Directed Order to buy 100 contracts at \$1.06 directed to MM2:

The order is posted on the BX Options book at \$1.05 and displayed at \$1.04¹⁸

CBOE updates its quote to \$1.00 x \$1.07 (size 10 x 10)

The new NBBO is \$1.00 x \$1.06 (size 160 x 150)

The Directed Order can now execute against the BX Options book at \$1.06 as follows:

40 contracts execute against MM2 Quote B as a Directed Allocation (40% of the 100 contract buy order)

60 contracts execute against MM1 Quote A

The Exchange believes that it is useful and beneficial for the order to retain its status as a Directed Order, because this handling is consistent with the order instructions and original intent of the submitting Participant. On other options exchanges, the “directed

¹⁸ See Chapter VI, Section 11.

order” designation is only considered upon receipt of the order.¹⁹ BX believes that its Participants may find this feature attractive; otherwise, Participants might consider cancelling and re-entering the order so it is treated as a Directed Order, which would be less efficient and would increase message traffic. BX does not believe that retaining directed order status on the book is controversial or inconsistent with the Act. Nor does BX believe that it undermines the policy underpinnings of directed order programs. Rather, it is an innovative enhancement intended to make entering directed orders more efficient and modern. It is possible that more directed allocations will occur because orders retain their directed order status, but the same result could be achieved today by, inefficiently, reentering directed orders rather than leaving them on the book as non-directed orders.

In addition, the Directed Market Maker is entitled to the Directed Allocation at all price levels at which the Directed Market Maker has an order or quote. This is intended to reflect that orders are executable at multiple price levels, and that, today, market makers can enter orders at multiple price levels.

Example 7 (Price/Time or Pro-Rata – same outcome)

NBBO: \$1.00 x \$1.05

BX Options Book

MM1 Quote A \$1.00 x \$1.05 (size 20 x 20)
MM2 Quote B \$1.00 x \$1.05 (size 10 x 10)
MM3 Quote C \$1.00 x \$1.06 (size 100 x 100)

¹⁹ See e.g., Phlx Rule 1080(l)(ii), which provides: When the Exchange's disseminated price is the NBBO *at the time of receipt* of the Directed Order, and the Directed Specialist, SQT or RSQT is quoting at the Exchange's disseminated price, the Directed Order shall be automatically executed and allocated in accordance with Rule 1014(g)(viii).

MM2 Quote D \$1.00 x \$1.06 (size 50 x 50)

BX Options Best Offer: 30 at \$1.05

BX receives a Directed Order to buy 110 contracts at \$1.06 directed to MM2:

20 contracts execute against MM1 Quote A

10 contracts execute against MM2 Quote B

\$1.05 price level is completely exhausted

32 contracts execute against MM2 Quote D as a Directed Allocation (40% of 80 remaining contracts from buy order)

48 contracts execute against MM3 Quote C

New Quoting Requirement for All Market Makers

BX also proposes to change the quoting obligation applicable to its Market Makers. Currently, Chapter VII, Section 6(d) provides that on a daily basis, a Market Maker must during regular market hours make markets consistent with the applicable quoting requirements specified in these rules, on a continuous basis in at least sixty percent (60%) of the series in options in which the Market Maker is registered. It further provides that, to satisfy this requirement with respect to quoting a series, a Market Maker must quote such series 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 90% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances.

BX proposes to better align its market maker quoting requirement with that of other exchanges, such as NYSE Arca and NYSE MKT. Specifically, BX proposes to reduce the quoting requirement for non-Directed BX Options Market Makers as follows: a Market Maker must quote such options 60% of the trading day (as a percentage of the

total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 60% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances. This obligation will apply to all of a Market Maker's registered options collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis. This is the same requirement as on other options exchanges.²⁰

BX believes that this is appropriate for two reasons. First, BX's current Market Maker quoting requirement is much more stringent than certain other exchanges. Quoting *each series* 90% of the trading day is much more stringent than looking at all options in which a Market Maker is registered, because it allows for some number of series not to be quoted at all, as long as the overall standard is met. This better accommodates the occasional issues that may arise in a particular series, whether technical or manual. The existing requirement may at times discourage liquidity in particular options series because a market maker is forced to focus on a momentary lapse rather than using the appropriate resources to focus on the options series that need and consume additional liquidity. As a new market, BX believes that it can better attract Market Makers to the BX Options market and grow its market if its quoting obligation is more in line with that of other exchanges. In addition, as BX seeks to introduce directed orders, the market maker quoting obligation has become an obstacle to crafting a competitive, attractive directed order program. Specifically, because the Commission has required directed participants to be subject to heightened quoting obligations as compared to non-directed

²⁰ See NYSE Arca Rule 6.88 and NYSE MKT Rule 964.1NY.

market makers, BX would have to adopt a Directed Market Maker quoting obligation more stringent than the current 90% of the time/60% of the series requirement for regular BX Options Market Makers. BX does not believe that a quoting requirement for greater than 90% of the time would attract Directed Market Makers to BX Options, as BX embarks on growing its market with new functionality and features. In fact, a more stringent quoting requirement would likely discourage new market makers from participating in the BX Options market and inhibit current market makers' ability to provide liquidity effectively.

New Quoting Requirement for Directed Market Makers

New Section 10(3)(iv)(D) makes clear that Directed Market Makers are subject to the quoting requirements of new Chapter VII, Section 6(d)(iv). Specifically, in options in which it receives Directed Orders, a Directed Market Maker must quote 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance. BX Regulation may consider exceptions to the requirement to quote 90% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances. This obligation will apply collectively to all series in all of the options in which the Directed Market Maker receives Directed Orders, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis. This quoting obligation is more stringent than that which is applicable to regular BX Options Market Makers, who will now have to quote, under this proposal, at least 60% of the time the Exchange is open for trading in registered options. Such quotations must meet the quote width requirements of Chapter VII, Section 6(d)(ii). Once a Directed Market Maker

receives a Directed Order, the heightened quoting obligation is triggered and applies to the options in which the Directed Market Maker receives Directed Orders.

Lastly, Section 10(3)(iv)(E) will provide that the Exchange will determine which options have the Directed Allocation functionality available.²¹ BX will issue an Options Trader Alert to inform its Participants in which options the Directed Allocation will be available.

Conclusion

In summary, BX seeks to compete with the many options exchanges that offer directed orders in their respective markets and seeks to introduce directed order functionality, as described above.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act²² in general, and furthers the objectives of Section 6(b)(5) of the Act²³ 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 mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest, because it will establish a directed order process similar to what operates on other exchanges, as explained in detail herein,

²¹ Directed Orders received in options where BX Options is not offering Directed Order processing will not be rejected; instead, such orders will be handled normally as non-Directed Orders.

²² 15 U.S.C. 78f(b).

²³ 15 U.S.C. 78f(b)(5).

which will provide Participants with additional choices among the many competing exchanges with regard to their execution needs and strategies. BX Options operates in an intensely competitive environment and seeks to offer the same services that its competitors offer and in which its customers find value.

In its approval of other options exchange directed order programs, the Commission has, like proposals to amend a specialist guarantee, focused on whether the percentage of the “entitlement” would rise to a level that could have a material adverse impact on quote competition within a particular exchange, and concluded that such programs do not jeopardize market integrity or the incentive for market participants to post competitive quotes.²⁴ BX’s proposed Directed Allocation of 40% is consistent with the directed order allocations of other options exchanges, except for the impact of rounding up, as described above, which BX does not believe is significant. BX notes that the remaining portion of each order will still be allocated based on the competitive bidding of market participants. In addition, at the time of execution, a BX Options Directed Market Maker will have to be quoting at the NBBO for the size of the Directed Allocation to receive the Directed Allocation, which is intended to incent the Directed Market Maker to quote aggressively, because he cannot merely step up and match the NBBO after the Directed Order is received. Similarly, BX believes there is an incentive for Directed Market Makers to quote competitively even though they may receive a Directed Allocation when such Directed Market Maker is not on the NBBO at the time of order receipt, but is at the time of execution. BX also notes that BX Options Directed

²⁴ See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (SR-Phlx-2004-91).

Market Makers will have greater quoting obligations than other BX Options Market Makers.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The competition among the options exchanges is vigorous and this proposal is intended to afford the BX Options market the opportunity to compete for directed order flow. In that regard, the proposal is pro-competitive and will offer market participants an additional venue for the execution of directed orders. The Exchange does not believe that the proposal imposes a burden on intra-market competition not necessary or appropriate in furtherance of the purposes of the Act, because the ability to send directed orders is available to all Participants, and the ability to become a Market Maker is available to all Market Makers.

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

No written comments were either solicited or received.

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

Within 45 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 shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change 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 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-BX-2013-016 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-BX-2013-016. 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 website viewing and printing 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 offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-BX-2013-016, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁵

Kevin M. O'Neill
Deputy Secretary

²⁵ 17 CFR 200.30-3(a)(12).