

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 82	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4		File No.* SR - 2014 - * 035	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"/>			
<b>Description</b>				
Provide a brief description of the action (limit 250 characters, required when Initial is checked *).				
<input type="text" value="Relating to Market Maker Quoting Obligations and the Introduction of a Lead Market Maker"/>				
<b>Contact Information</b>				
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.				
First Name *	<input type="text" value="Angela"/>	Last Name *	<input type="text" value="Dunn"/>	
Title *	<input type="text" value="Associate General Counsel"/>			
E-mail *	<input type="text" value="angela.dunn@nasdaqomx.com"/>			
Telephone *	<input type="text" value="(215) 496-5692"/>	Fax	<input type="text"/>	
<b>Signature</b>				
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	<input type="text" value="06/19/2014"/>	<input type="text" value="Executive Vice President and General Counsel"/>		
By	<input type="text" value="Edward S. Knight"/>	<input type="text"/>		
(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.				
<input type="button" value="Persona Not Validated - 1383935917270"/>				

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) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> NASDAQ OMX BX, Inc. (“BX” or the “Exchange”) is filing with the Securities and Exchange Commission (“Commission”) a proposal to: (1) amend BX Market Maker quoting obligations; (2) adopt new BX Rules at Chapter VII, Section 13 and 14 to allow qualified Options Participants to act as a Lead Market Maker, or LMM, in one or more options classes; (3) revise priority rules to entitle LMMs participation entitlement; and (4) provide for a Public Customer priority overlay for the Price/Time Execution Algorithm.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1 and the text of the proposed Rule is attached hereto as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Board of Directors of the Exchange approved a portion of the submission of this proposed rule change on May 20, 2014. Additionally, a portion of the proposed rule change was approved by senior management of the Exchange pursuant to authority delegated by the Board of Directors of the Exchange on July 17, 2013. Exchange staff will advise the Board of Directors of any action taken pursuant to delegated authority. No other action by the Exchange is necessary for the filing of the rule change.

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

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

Questions regarding this rule filing may be directed to Angela Saccomandi Dunn, Associate General Counsel, at (215) 496-5692.

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

a. Purpose

The purpose of the proposed rule change is to amend the current BX Market Maker quoting obligations and adopt rules to permit BX Market Makers to act as Lead Market Makers, or LMMs, in one or more options classes, provided the LMM meets certain obligations and quoting requirements as provided for in the new proposed Exchange Rules. The Exchange proposes to provide assigned LMMs with certain participation entitlements. Finally, the Exchange proposes to provide Public Customers with priority when the Price/Time execution algorithm is in effect. The Exchange believes that these amendments, which will be described below in greater detail, will enhance competition on the Exchange by rewarding LMMs who meet certain obligations on BX.

BX Market Maker Quoting Obligations

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, Inc. (“NYSE Arca”) and NYSE MKT LLC (“NYSE MKT”). Specifically, BX proposes to reduce the quoting requirement for 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 quoting obligation will apply to all of a Market Maker’s registered options *collectively* on a daily basis, rather than on an option-by-option basis. This quoting obligation will be reviewed on a monthly basis, and allows the Exchange to review the Market Makers’ daily compliance in the aggregate and determine the appropriate disciplinary action for single or multiple failures to comply with the continuous quoting requirement during the month period. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve a Market Maker of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against a Market Maker for failing to meet the continuous quoting obligation each trading day. This is the same requirement as on other options exchanges.<sup>3</sup>

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.

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<sup>3</sup> See NYSE Arca Rule 6.37B(c) and NYSE MKT Rule 925.1NY(c).

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. 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.

The Exchange believes that the amendments to Section 6(d)(i)(1) of Chapter VII, which would allow applying the quoting requirements for Market Makers collectively across all options classes, is a fair and more efficient way for the Exchange and market participants to evaluate compliance with the continuous quoting requirements. Applying the continuous quoting requirement collectively across all option classes rather than on an issue-by-issue basis is beneficial to Market Makers by providing some flexibility to choose which series in their appointed classes they will continuously quote--increasing the continuous quoting obligation in the series of one class to allow for a decrease in the continuous quoting obligation in the series of another class. This flexibility does not, however, diminish the Market Maker's obligation to continuously quote a significant part of the trading day in a significant percentage of series. Flexibility is important for classes that have relatively few series and may prevent the Market Maker, in particular, from breaching the continuous quoting requirement when failing to meet the specified quote

amount during the trading day (as proposed) in more than one series in an appointed class. However, this flexibility does not act to relieve the Market Maker of his continuous quoting obligations and does not, for example, relieve the Market Maker from providing liquidity in classes experiencing heightened volatility. The Exchange provides in the proposed rule that determining compliance with the continuous quoting requirement on a monthly basis will not relieve a Market Maker of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against a Market Maker for failing to meet the continuous quoting obligation each trading day. The Exchange believes that the balance between the benefits provided to Market Makers and the obligations imposed upon Market Makers by the proposed rule change is appropriate.

The Exchange believes that the proposal will not diminish, and in fact may increase, market making activity on the Exchange, by establishing quoting compliance standards that are reasonable and are already in place on other options exchanges. By amending Section 6 of Chapter VII to state that quoting obligations apply to a Market Maker's appointed issues collectively, this proposal is similar to that of other options markets and puts the Exchange on an equal competitive footing.<sup>4</sup> Moreover, as discussed the Exchange believes that the proposal may increase market making activity on the Exchange by establishing quoting compliance standards that are reasonable and already in place on other options exchanges.

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<sup>4</sup> The proposed rule text is, as noted, similar in all material respects to BATS Exchange, Inc. ("BATS") Rule 22.6(d)(3) and NASDAQ OMX PHLX LLC ("Phlx") Rule 1014.

Lead Market Makers Allocations

Today on BX there are two types of Options Participants, Options Order Entry Firms and Options Market Makers. Options Order Entry Firms, or OEFs, are Options Participants who represent customer orders as agent on BX Options and non-Market Maker Participants conducting proprietary trading as principal. Options Market Makers are Options Participants registered with the Exchange as Options Market Makers in one or more listed options on BX.<sup>5</sup> BX may suspend or terminate any registration of an Options Market Maker when, in BX's judgment, the interests of a fair and orderly market are best served by such action.

To become an Options Market Maker, an Options Participant is required to register by filing a written application. BX does not place any limit on the number of entities that may become Options Market Makers. BX Options Market Makers are required to electronically engage in a course of dealing to enhance liquidity available on BX and to assist in the maintenance of fair and orderly markets.<sup>6</sup> Among other things, Options Market Makers must maintain minimum net capital in accordance with SEC and BX Options Rules. The Exchange is proposing herein that Options Market Makers must quote 60% of the trading day (as a percentage of the total number of minutes in such

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<sup>5</sup> See BX Options Rules at Chapter VII.

<sup>6</sup> Options Market Makers receive certain benefits for carrying out their duties. For example, a lender may extend credit to a broker-dealer without regard to the restrictions in Regulation T of the Board of governors of the Federal Reserve System if the credit is to be used to finance the broker-dealer's activities as market maker on a national securities exchange. Thus, an Options Market Maker has a corresponding obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis to justify this favorable treatment.

trading day) or such higher percentage as BX may announce in advance.<sup>7</sup> 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. Market Makers shall not be required to make two-sided markets pursuant to Section 5(a)(i) of Chapter VII in any Quarterly Option Series, adjusted option series, or 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,<sup>8</sup> or any series with an expiration of nine months or greater. However, a LMM may still receive a participation entitlement in such series if it elects to quote in such series and otherwise satisfies the requirements of Chapter VI, Section 10. 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 these calculations with respect to the affected quotes.<sup>9</sup> Options Market Makers must also comply with certain bid/ask differentials (quote spread parameters).<sup>10</sup> Options on equities (including Exchange-

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<sup>7</sup> As noted herein, today BX Options Market Makers 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.

<sup>8</sup> 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.

<sup>9</sup> Substantial or continued failure by an Options Market Maker to meet any of its obligations and duties, will subject the Options Market Maker to disciplinary action, suspension, or revocation of the Options Market Maker's registration in one or more options series.

<sup>10</sup> See BX Options Rules at Chapter VII, Section 6.

Traded Fund Shares), and on index options must be quoted with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid, including before and during the opening.<sup>11</sup> However, respecting in-the-money series where the market for the underlying security is wider than \$5, the bid/ask differential may be as wide as the quotation for the underlying security on the primary market.<sup>12</sup>

At this time, the Exchange is proposing a third type of Options Participant, an LMM. Approved BX Options Market Makers<sup>13</sup> may become an LMM in one or more listed options. Initial application(s) to become an LMM shall be in a form and/or format prescribed by the Exchange and shall include the following: (1) background information on the LMM including experience in trading options; (2) the LMM's clearing arrangements; (3) adequacy of capital; and (4) adherence to Exchange rules and ability to meet obligations of an LMM.<sup>14</sup> Subsequent applications shall be in a form and/or format prescribed by the Exchange and shall include the information requested therein, including, but not limited to, an account of the abilities and background of the applicant as well as any other special requirements that the Exchange may require.<sup>15</sup> Once an applicant is approved by the Exchange as an LMM, any material change in capital shall be reported in writing to the Exchange within two business days after the change. BX

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<sup>11</sup> Id.

<sup>12</sup> Id.

<sup>13</sup> See Chapter VII, Section 2.

<sup>14</sup> See proposed BX Options Rules at Chapter VII, Section 13(A)(b).

<sup>15</sup> See proposed BX Options Rules at Chapter VII, Section 13(A)(c).

will not place any limit on the number of entities that may become LMMs, however the Exchange notes that there will only be one LMM per class.

When an options class is to be allocated or reallocated by the Exchange, the Exchange will solicit applications from all eligible LMMs. If the Exchange determines that special qualifications should be sought in the successful applicant, it shall indicate such desired qualifications in the notice.<sup>16</sup>

Further, the Exchange proposes to require an allocation application to be submitted in writing to the Exchange's designated staff and shall include, at a minimum, the name and background of the LMM, the LMM's experience and capitalization demonstrating an ability to trade the particular options class sought, and any other reasons why the LMM believes it should be assigned or allocated the security. In addition, the Exchange may also require that the application include other information such as system acceptance/execution levels and guarantees. The Exchange may re-solicit applications for any reason, including if it determines that its initial solicitation resulted in an insufficient number of applicants.<sup>17</sup>

Allocation decisions and automatic allocations shall be communicated in writing to Exchange members. Once the LMM is allocated an issue, such LMM shall immediately notify the Exchange in writing of any change to the respective system acceptance/execution levels or any other material change in the application for any assigned issue. If an LMM seeks to withdraw from allocation in a security, it should so

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<sup>16</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(a).

<sup>17</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(b).

notify the Exchange at least one business day prior to the desired effective date of such withdrawal.<sup>18</sup>

Options on Related Securities shall be automatically allocated to the LMM that is already the LMM in Currently Allocated Securities (as defined hereafter). Only one LMM may be allocated to an options class. The Exchange is defining the term “Related Securities” for purpose of Chapter VII, Section 13 as follows: “Related Securities means, but is not limited to: securities of a partially or wholly owned subsidiary; securities that are convertible into the securities of the issuer; warrants on securities of the issuer; securities issued in connection with a name change; securities issued in a reverse stock split; contingent value rights; ”tracking” securities designed to track the performance of the underlying security or corporate affiliate thereof; securities created in connection with the merger or acquisition of one or more companies; securities created in connection with a “spin-off” transaction; convertible on non-convertible senior securities; and securities into which a listed security is convertible, where such Related Securities emanate from or are related to securities underlying options that are currently allocated to a LMM on the Exchange (“Currently Allocated Options”). The term Related Securities does not include Exchange Traded Funds.<sup>19</sup>

The Exchange shall allocate new options classes, or reallocate existing options classes to applicants based on the results of such factors as the Exchange deems appropriate. Among the factors that the Exchange may consider in making such decisions are: the number and type of securities in which applicants are currently

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<sup>18</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(c)(d) and (e).

<sup>19</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(f).

registered; the capital and other resources of the applicant; recent allocation decisions within the past eighteen months; the desirability of encouraging the entry of new LMMs into the Exchange's market; order flow commitments; any prior transfers of LMM privileges by the applicant and the reasons therefore and such policies as the Board instructs the Exchange to follow in allocating or reallocating securities. The Exchange may also consider: quality of markets data; observance of ethical standards and administrative responsibilities. Solely with respect to options class allocations or reallocations, past or contemplated voluntary delisting of options by LMMs, done in the best interest of the Exchange, will not be viewed negatively by the Exchange in making allocation and reallocation decisions. The Exchange is empowered to allocate option classes for a limited period of time or subject to such other terms and conditions as it deems appropriate.<sup>20</sup>

Requests to allocate or transfer allocation, or transfer of an options class request must be made in writing to the Exchange and such transfer may only be made to an approved LMM. The LMM shall be assigned to an options class for a period defined by the Exchange. The Exchange will communicate such period in solicitation applications (notices). The Exchange may re-allocate an options class after the defined period has expired.<sup>21</sup>

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<sup>20</sup> See proposed BX Options Rules at Chapter VII, Section 13(C).

<sup>21</sup> See proposed BX Options Rules at Chapter VII, Section 13(D).

The proposed rules relating to the appointment of LMMs and the allocation of option series are similar to rules currently in place on NASDAQ OMX PHLX LLC (“Phlx”) with respect to its appointment of specialists.<sup>22</sup>

#### LMM Obligations and Quotations

The Exchange also requires that LMM transactions should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and no LMM should enter into transactions or make bids or offers that are inconsistent with such a course of dealings.<sup>23</sup> Further, with respect to each class of options in his or her appointment, an LMM is expected to engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class. Without limiting the foregoing, an LMM is expected to perform the following activities in the course of maintaining a fair and orderly market pursuant to proposed Chapter VII, Section 14(b): (i) to compete with other Market Makers to improve the market in all series of options classes to which the LMM is appointed; (ii) to make markets that will be honored for the number of contracts entered into the Trading System<sup>24</sup> in all series of options classes within the LMM's appointment; (iii) to update market quotations in

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<sup>22</sup> See Phlx Rules 501, 505, 506 and 511.

<sup>23</sup> See proposed BX Options Rules at Chapter VII, Section 14(a).

<sup>24</sup> See Chapter I, Section 1(62). The term “Trading System” or “System” means the automated trading system used by BX Options for the trading of options contracts.

response to changed market conditions in all series of options classes within the LMM's appointment; (iv) options traded on the Trading System may be quoted with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid; and . (v) BX Regulation may establish quote width differences other than as provided in subparagraph (iv) for one or more options series. In the event the bid/ask differential in the underlying security is greater than the bid/ask differential set forth in subsection (b)(iv)-(v) of Section 14 the permissible price differential for any in-the-money option series may be identical to those in the underlying security market. In the case of the at-the-money and out-of-the-money series, BX Regulation may waive the requirements of subsections (b)(iv)-(v) of Section 14 on a case-by-case basis when the bid/ask differential for the underlying security is greater than .50. In such instances, the bid/ask differentials for the at-the-money series and the out-of-the-money series may be half as wide as the bid/ask differential in the underlying security in the primary market. Exemptions from subsections (b)(iv)-(v) are subject to Exchange review. BX Regulation must file a report with BX operations setting forth the time and duration of such exemptive relief and the reasons therefore.<sup>25</sup>

With respect to unusual conditions, if the interest of maintaining a fair and orderly market so requires, BX Regulation may declare that unusual market conditions exist in a particular issue and allow LMMs in that issue to make auction bids and offers with spread differentials of up to two times, or in exceptional circumstances, typically up to three times, the legal limits permitted under this Rule. In making such determinations to allow wider markets, BX Regulation should consider the following factors: (A) whether

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<sup>25</sup> See proposed BX Options Rules at Chapter VII, Section 14(b).

there is pending news, a news announcement or other special events; (B) whether the underlying security is trading outside of the bid or offer in such security then being disseminated; (C) whether Options Participants receive no response to orders placed to buy or sell the underlying security; and (D) whether a vendor quote feed is clearly stale or unreliable.<sup>26</sup> In the event that BX Regulation determines that unusual market conditions exist in any option, it will be the responsibility of BX Regulation to file a report with BX operations setting forth the relief granted for the unusual market conditions, the time and duration of such relief and the reasons therefore.

In classes of options other than those to which the LMM is appointed, LMMs should not engage in transactions for an account in which they have an interest that are disproportionate in relation to, or in derogation of, the performance of their obligations as specified in this Rule with respect to the classes in their appointment. Furthermore, LMMs should not: (1) individually or as a group, intentionally or unintentionally, dominate the market in option contracts of a particular class; and (2) effect purchases or sales on the Exchange except in a reasonable and orderly manner.<sup>27</sup>

LMMs are prohibited from the following: (1) any practice or procedure whereby LMMs trading any particular option issue determine by agreement the spreads or option prices at which they will trade that issue; and (2) any practice or procedure whereby LMMs trading any particular option issue determine by agreement the allocation of orders that may be executed in that issue.<sup>28</sup>

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<sup>26</sup> See proposed BX Options Rules at Chapter VII, Section 14(c).

<sup>27</sup> See proposed BX Options Rules at Chapter VII, Section 14(d).

<sup>28</sup> See proposed BX Options Rules at Chapter VII, Section 14(e).

An LMM may enter quotations only in the issues included in its appointment. An LMM must provide continuous two-sided quotations throughout the trading day in its appointed issues for 90% of the time the Exchange is open for trading in each issue. Such quotations must meet the legal quote width requirements herein. These obligations will apply to all of the LMMs appointed issues collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis.<sup>29</sup> 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. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve an LMM of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against an LMM for failing to meet the continuous quoting obligation each trading day.

If a technical failure or limitation of a system of the Exchange prevents an LMM from maintaining, or prevents a LMM from communicating to the Exchange, timely and accurate electronic quotes in an issue, the duration of such failure shall not be considered in determining whether the LMM has satisfied the 90% quoting standard with respect to that option issue. The Exchange may consider other exceptions to this continuous electronic quote obligation based on demonstrated legal or regulatory requirements or other mitigating circumstances.<sup>30</sup> An LMM may be called upon by BX Regulation to submit a single quote or maintain continuous quotes in one or more series of an option

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<sup>29</sup> See proposed BX Options Rules at Chapter VII, Section 14(f).

<sup>30</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(1).

issue within its appointment whenever, in the judgment of BX Regulation, it is necessary to do so in the interest of maintaining fair and orderly markets.<sup>31</sup>

An LMM shall be compelled to buy/sell a specified quantity of option contracts at the disseminated bid/offer pursuant to his obligations with respect to firm quotes. All quotes and orders entered into the System by Options Participants are firm under this Rule and Rule 602 of Regulation NMS under the Exchange Act (“SEC Rule 602”) for the number of contracts specified and according to the size requirements set forth herein. Market Maker bids and offers are not firm under this Rule and SEC Rule 602: (1) for the period prior to the Opening Cross; or (2) if any of the circumstances provided in paragraph (b)(3) or (c)(4) of SEC Rule 602 exist.<sup>32</sup> These obligations of this Rule shall not apply to LMMs with respect to adjusted option series, quarterly options series, or any series with a time to expiration of nine months or greater. For purposes of this Rule, an adjusted option series is an option series wherein, as a result of a corporate action by the issuer of the underlying security, one option contract in the series represents the delivery of other than 100 shares of underlying security.<sup>33</sup>

These LMM obligations are based on rules of NYSE Arca.<sup>34</sup>

#### Lead Market Maker Priority

The Exchange proposes to provide LMM participation entitlements in Chapter VI (Trading Systems) at Section 10, entitled “Book Processing.” Specifically, with respect

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<sup>31</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(2).

<sup>32</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(3).

<sup>33</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(4).

<sup>34</sup> See 6.37A and 6.37B of NYSE Arca, Inc.’s Rulebook.

to Size Pro-Rata executions, the Exchange would afford an LMM a participation entitlement if the LMM's bid/offer is at the Exchange's disseminated price and all Public Customer<sup>35</sup> orders have been fully executed.<sup>36</sup> The LMM shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. LMM participation entitlements will be considered after the opening process. The LMM participation entitlement is as follows: (1) A BX Options LMM shall receive the greater of: the LMM's Size Pro-Rata share; 50% of remaining interest if there is one or no other Market Maker at that price; 40% of remaining interest if there are two other Market Makers at that price; or 30% of remaining interest if there are more than two other Market Makers at that price; or if rounding would result in an allocation of less than one contract, a BX Options LMM shall receive one contract. Rounding will be up or down to the nearest integer.

Orders for 5 contracts or fewer shall be allocated to the LMM. The Exchange will review this provision quarterly and will maintain the small order size at a level that will not allow orders of 5 contracts or less executed by the LMM to account for more than 40% of the volume executed on the Exchange. After all Public Customer orders have been fully executed and LMM participation entitlements applied, if applicable, BX Options Market Makers shall have priority over all other Participant orders at the same price.

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<sup>35</sup> See Chapter I, Section 1(50). The term "Public Customer" means a person that is not a broker or dealer in securities.

<sup>36</sup> Price Improving Orders will retain price priority before an LMM participation entitlement is provided at the Exchange's disseminated price. See Chapter VI, Sections 1(a)(6) and 7(b)(3)(B).

Several examples of the manner in which an LMM will be allocated pursuant to the Size Pro-Rata model follow below.

*Example Number 1:*

ABBO = 1.00 – 1.10  
BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
Firm 5 contracts offered at 1.10  
LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
Customer B 1 contract offered at 1.10

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

Customer B trades 1 contract at 1.10

LMM trades 4 contracts at 1.10

*Example Number 2:*

ABBO = 1.00 – 1.10  
BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
Firm 5 contracts offered at 1.10  
LMM: 1.00 bid (10 contracts) – 1.10 offer (3 contracts)  
Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (30 contracts)

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

LMM trades 3 contracts at 1.10

MM1 trades 0 contracts at 1.10  $((10/40)*2)$  [rounded down based on normal pro-rata]

MM2 trades 1 contracts at 1.10  $((30/40)*2)$  [rounded down based on normal pro-rata]

MM1 then trades the 1 residual contract based on time

*Example # 3:*

ABBO = 1.00 – 1.10

BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

LMM: 1.00 bid (10 contracts) – 1.10 offer (15 contracts)

Customer A 5 contracts offered at 1.10

Firm 5 contracts offered at 1.10

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer B 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 5 contracts, Customer B trading 2 contracts, LMM trading 11 contracts  $(15/45*33)$  remaining), MM1 trading 14 contracts  $(20/45*33)$ , MM2 trading 7 contracts  $(10/45*33)$ , and then LMM based on time receiving an additional 1 lot.

LMM allocation would result in Customer A trading 5 contracts, Customer B trading 2 contracts, and LMM trading 40% of remaining 33 contracts = 13 (13.2 rounded down); then Size Pro-Rata for remaining with MM1 trading 13 contracts  $(20/30*20)$  and MM2 trading 6 contracts  $(10/30*20)$  and LMM trading an additional 1 lot based on time.

Pursuant to proposed Chapter VI, Section 10(1)(C)(2)(ii)(1), LMM allocation would prevail in this example because the LMM receives greater allocation.

*Example # 4:*

ABBO = 1.00 – 1.10

BX BBO = 1.00 – 1.10 comprised of the following in order of receipt

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer A 10 contracts offered at 1.10  
 Firm 15 offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B: 10 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 10 contracts, Customer B trading 10 contracts, LMM trading 6 contracts (10/30\*20 remaining rounded down), MM1 trading 6 contracts (10/30\*20), MM2 trading 6 contracts (10/30\*20), and then MM1 and LMM based on time each receiving an additional 1 lot.

LMM allocation would result in Customer A trading 10 contracts, Customer B trading 10 contracts, and LMM trading 40% of remaining 20 contracts = 8; then normal pro rata resumes with MM1 and MM2 each being allocated 6 contracts.

Pursuant to proposed Chapter VI, Section 10(1)(C)(2)(ii)(1), LMM allocation would prevail in this example because the LMM receives greater allocation.

*Example Number 5:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 25 offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Market Maker 2: 1.00 bid (5 contracts) – 1.10 offer (10 contracts)  
 Market Maker 3 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer B trading 2 contracts, MM1 trading 6 contracts (10/60\*38), LMM trading 12 (20/60\*38), MM2 trading 6 contracts (10/60\*38), and MM3 trading 12 contracts (20/60\*38) and then MM1 and LMM each trading an additional 1 contract based on time.

LMM allocation would result in Customer B trading 2 contracts and LMM trading 30% of remaining 38 contracts = 11 (11.4 rounded down); then normal pro rata resumes and MM1 trades 6 contracts (10/40\*27), MM2 trades 6 (10/40\*27), and MM3 trades 13 contracts (20/40\*27) and MM1 and LMM each trade an additional 1 lot based on time.

Size Pro-Rata allocation would prevail because the LMM receives greater allocation that way pursuant to proposed Chapter VI, Section 10(1)(C)(2)(ii)(1).

With respect to Price/Time executions, the Exchange proposes to provide that the highest bid and lowest offer shall have priority except that Public Customer orders shall have priority over non-Public Customer orders at the same price. Today, Public Customer orders do not have priority over non-Public Customer orders at the same price. If there are two or more Public Customer orders for the same options series at the same price, priority shall be afforded to such Public Customer orders in the sequence in which they are received by the System. For purposes of this Rule, a Public Customer order does not include a Professional Order. Public Customer Priority is always in effect when Price/Time execution algorithm is in effect.<sup>37</sup> The Exchange is proposing to add a sentence to the rule text at Chapter VI, Section 10(1)(C)(1)(a) to state that Public Customer Priority is always in effect when the Price/Time execution algorithm is in effect. This is a substantive change which will provide Public Customer orders with priority over non-Public Customer orders at the same price for executions under the Price/Time execution algorithm. Similar language is also being added to Chapter VI, Section 10(1)(C)(2)(i) to conform the Size Pro-Rata language for clarity. Public

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<sup>37</sup> See proposed Chapter VI, Section 10(1)(C)(1)(a).

Customer priority has been in effect when the Size Pro-Rata execution algorithm has been in effect. This amendment to the Size Pro-Rata language seeks to clarify Public Customer priority with respect to that algorithm. The Public Customer priority overlay recognizes the unique status of customers in the marketplace and the role their orders play in price competition and adding depth to the marketplace.

The Exchange proposes that LMM participant entitlements may be in effect when the Public Customer Priority Overlay is also in effect. After all Public Customer orders have been fully executed, upon receipt of an order, provided the LMM's bid/offer is at the Exchange's disseminated price, the LMM will be afforded a participation entitlement.<sup>38</sup> The LMM shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. A BX Options LMM shall receive the greater of: (a) contracts the LMM would receive if the allocation was based on time priority with Public Customer priority; (b) 50% of remaining interest if there is one or no other Market Maker at that price; (c) 40% of remaining interest if there are two other Market Makers at that price; or (d) 30% of remaining interest if there are more than two other Market Makers at that price or if rounding would result in an allocation of less than one contract, a BX Options LMM shall receive one contract. Rounding will be up or down to the nearest integer.

Orders for 5 contracts or fewer shall be allocated to the LMM. The Exchange will review this provision quarterly and will maintain the small order size at a level that will

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<sup>38</sup> Price Improving Orders will retain price priority before an LMM participation entitlement is provided at the Exchange's disseminated price. See Chapter VI, Sections 1(a)(6) and 7(b)(3)(B).

not allow orders of 5 contracts or less executed by the LMM to account for more than 40% of the volume executed on the Exchange.

Several examples of the manner in which an LMM will be allocated pursuant to the Price/Time model follow below.

*Example Number 1:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer A: 5 contracts offered at 1.10  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Price/Time with Customer priority results in Customer A trading 5 contracts, Customer B trading 2 contracts, Market Maker 1 trading 10 contracts, LMM trading 20 contracts, and Firm trading 3 contracts

LMM allocation would result in Customer A trading 5 contracts, Customer B trading 2 contracts, and LMM trading 40% of remaining 33 contracts = 13 (13.2 rounded down); then normal price time resumes and Market Maker1 trades 10 contracts, Firm trades 5 contracts, and LMM trades an additional 5 contracts

Price/Time with Customer priority would prevail because LMM allocation results in a greater allocation pursuant to proposed Chapter VI, Section 10(1)(a).

*Example Number 2:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer A 10 contracts offered at 1.10  
 Firm 15 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B 10 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Price/Time with Customer priority results in Customer A trading 10 contracts, Customer B trading 10 contracts, Market Maker 1 trading 10 contracts, Firm trading 10 contracts

LMM allocation would results in Customer A trading 10 contracts, Customer B trading 10 contracts, and LMM trading 40% of remaining 20 contracts = 8; then Price/Time resumes and Market Maker 1 trades 10 contracts and Firm trades 2 contracts

LMM allocation would prevail because the LMM receives a greater allocation with this calculation pursuant to proposed Chapter VI, Section 10(1)(C)(1)(b)(1).

*Example Number 3:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 25 contracts offered at 1.10  
 LMM 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Customer B 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Price/Time with Customer priority results in Customer B trading 2 contracts, Market Maker 1 trading 10 contracts, Firm trading 25 contracts, and LMM trading 3 contracts

LMM allocation would results in Customer B trading 2 contracts and LMM trading 50% of remaining 38 contracts = 19; then normal price time resumes and MM1 trades 10 contracts and Firm trades 9 contracts

LMM allocation would prevail because the LMM receives a greater allocation with this calculation pursuant to proposed Chapter VI, Section 10(1)(C)(1)(b)(1).

*Example Number 4:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B 1 contract offered at 1.10

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

Customer B trades 1 contract at 1.10  
 LMM trades 4 contracts at 1.10

*Example Number 5:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer A: 1 contract offered at 1.10  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (3 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

Customer A trades 1 contract at 1.10  
 Customer B trades 2 contracts at 1.10  
 LMM trades 2 contracts at 1.10

The Exchange desires to implement this rule change by rolling out the rule amendments on an option-by-option basis over a period of time. The Exchange would issue Options Trader Alerts in advance to inform market participants which symbols will be implemented on which dates.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>39</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>40</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. 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.

The Exchange believes that requiring Market Makers to provide continuous two-sided quotations 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 continues to promote just and equitable principles of trade, and to foster cooperation and coordination with persons engaged in facilitating transactions in securities. Further, the Exchange would apply the quoting requirement to all of a Market Maker's registered

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<sup>39</sup> 15 U.S.C. 78f(b).

<sup>40</sup> 15 U.S.C. 78f(b)(5).

options collectively to all appointed issues, rather than on an option-by-option basis and compliance with this obligation will be determined on a monthly basis.

The proposal supports the quality of the Exchange's market by helping to ensure that Market Makers will continue to be obligated to quote in series when necessary. Ultimately, the benefit the proposed rule change confers upon Market Makers is offset by the continued responsibilities to provide significant liquidity to the market to the benefit of market participants. While under the proposal there are quoting requirements changes, the Exchange does not believe that these changes reduce the overall obligations applicable to Market Makers.<sup>41</sup> Moreover, the Exchange believes that the proposal may increase market making activity on the Exchange and the quality of the Exchange's market by establishing quoting compliance standards that are reasonable and already in place on other options exchanges.<sup>42</sup>

The proposed rule change also protects investors and the public interest by creating more uniformity and consistency among the Exchange's rules related to Market Maker quoting obligations. Providing Market Makers with flexibility by providing the continuous quoting obligation collectively across all option classes will not diminish the Market Makers' obligation to continuously quote a significant part of the trading day in a significant percentage of series. Additionally, with respect to compliance standards, the Exchange believes that adopting the proposed standards will enhance compliance efforts by Market Makers and the Exchange, and are consistent with requirements currently in

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<sup>41</sup> In this respect, the Exchange notes that such Market Makers are subject to many obligations aside from quoting, including, for example, the obligation to maintain a fair and orderly market in their appointed classes, and the obligation to conduct the opening and enter continuous quotations in all of the series of their appointed options classes within maximum spread requirements.

<sup>42</sup> See supra note 4.

place on other options exchanges (*e.g.* BATS Rule 22.6(d)(3) and Phlx Rule 1014). The proposal ensures that compliance standards for continuous quoting, in particular regarding quoting obligations applying to all of a Market Maker's appointed issues collectively, will be the same on the Exchange as on other options exchanges. The Exchange believes that the proposal will not diminish and in fact may increase, market making activity on the Exchange by establishing quoting compliance standards that are reasonable and already in place on other options exchanges.

The proposed rules relating to LMM allocations seek to establish and promote just and equitable principles of trade by requiring each market maker who desires to be an LMM to submit an application to the Exchange providing certain basic information and other information as necessary. The solicitation process is intended to provide all LMMs an opportunity to seek allocations by requiring allocation applications to be submitted in writing to the Exchange with certain information. The Exchange intends to foster cooperation and coordination with LMMs by requiring information concerning the LMM's experience and capitalization and other information to ensure that an LMM is qualified when allocated option series. LMMs would be required to update information accordingly once they are assigned in an option series.

Exchange staff seeks to allocate option series by considering a number of factors including but not limited to, the number and type of securities in which applicants are currently registered; the capital and other resources of the applicant; recent allocation decisions within the past eighteen months; the desirability of encouraging the entry of new LMMs into the Exchange's market; order flow commitments; any prior transfers of LMM privileges by the applicant and the reasons therefore; quality of markets data; and

observance of ethical standards and administrative responsibilities and such policies as the Board instructs the Exchange to follow in allocating or reallocating securities. These factors are intended to assist the Exchange in determining which LMMs qualify for allocations and the LMM's ability to meet its obligations. The process of allocating securities considers such factors to protect investors and the public interest by allocating to qualified and responsible Options Participants. Further, an LMM may be called upon by BX Regulation to submit a single quote or maintain continuous quotes in one or more series of an option issue within its appointment whenever, in the judgment of BX Regulation, it is necessary to do so in the interest of maintaining fair and orderly markets. An LMM will be compelled to buy/sell a specified quantity of option contracts at the disseminated bid/offer pursuant to his obligations with respect to firm quotes.

With respect to an LMM's obligations, the Exchange would require LMMs be subject to heightened standards as compared to other market makers. An LMM must provide continuous two-sided quotations throughout the trading day in its appointed issues for 90% of the time the Exchange is open for trading in each issue. Such quotations must meet the legal quote width requirements herein. These obligations will apply to all of the LMMs appointed issues collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis. 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. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve an LMM of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange

from taking disciplinary action against an LMM for failing to meet the continuous quoting obligation each trading day.

LMM's transactions should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and no LMM should enter into transactions or make bids or offers that are inconsistent with such a course of dealings. An LMM is expected to engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class. The Exchange will obligate an LMM to certain conduct including: (1) to compete with other LMMs to improve the market in all series of options classes to which the LMM is appointed; (2) to make markets that will be honored for the number of contracts entered into the Trading System in all series of options classes within the LMM's appointment; (3) to update market quotations in response to changed market conditions in all series of options classes within the LMM's appointment; (4) to quote with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid; (5) to establish quote width differences other than as provided in subparagraph (4) for one or more options series; (6) and certain permissible price differentials.

With respect to classes of option contracts outside of their appointment, LMMs will not be permitted to engage in transactions for an account in which they have an interest that are disproportionate in relation to, or in derogation of, the performance of their obligations as specified in this Rule with respect to the classes in their appointment.

LMMs are also prohibited from entering into certain agreements that may undermine the LMMs obligations.

The Exchange believes that the obligations set forth for LMMs in its proposed rules will promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in facilitating transactions in securities, and, in general, to protect investors and the public interest.

The Exchange believes that offering LMMs participation entitlements promotes just and equitable principles of trade because LMMs will be held to a higher standard as compared to other market participants including Market Makers. A Market Maker would be required, pursuant to this proposal, to quote 60% of the trading day. LMMs are being held to a higher obligation and therefore are being rewarded with participation entitlements. Similar to Market Makers, LMMs add value through continuous quoting<sup>43</sup> and the commitment of capital.

In addition, the LMM quoting requirements promote liquidity and continuity in the marketplace in requiring LMMs to be held to a higher standard of quoting. The Exchange also believes that the proposed rule change supports the quality of the Exchange's markets because it maintains the quoting obligations of Market Makers as LMMs at 90%. LMM transactions must constitute a course of dealings reasonably

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<sup>43</sup> Pursuant to Chapter VII (Market Participants), Section 5 (Obligations of Market Makers), in registering as a market maker, an Options Participant commits himself to various obligations. Transactions of a Market Maker in its market making capacity must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and Market Makers should not make bids or offers or enter into transactions that are inconsistent with such course of dealings. See Chapter VII, Section 5. Further, all Market Makers are designated as specialists on BX for all purposes under the Act or rules thereunder. See Chapter VII, Section 2.

calculated to contribute to the maintenance of a fair and orderly market. Accordingly, the proposed rule change supports the quality of the Exchange's trading markets by helping to ensure that LMMs will be required to meet a higher quoting standard in order to reap the benefits of the participation entitlements. The Exchange believes this proposed change to offer participation entitlements to LMMs is offset by LMMs' continued responsibilities to provide significant liquidity to the market to the benefit of market participants.

The Exchange's proposal to add a sentence to the rule text at Chapter VI, Section 10(1)(C)(1)(a) to state that Public Customer Priority is always in effect when the Price/Time execution algorithm is in effect and also add language to Chapter VI, Section 10(1)(C)(2)(i) to conform the Size Pro-Rata language for clarity recognizes the unique status of customers in the marketplace and the role their orders play in price competition and adding depth to the marketplace. The Exchange believes that the Public Customer priority overlay is designed to promote just and equitable principles of trade and to protect investors and the public interest.

The proposed rule change also removes impediments to and allows for a free and open market, while protecting investors, by promoting transparency regarding LMMs' obligations and benefits in the Exchange Rules. In addition, the Exchange believes that the proposed rule change is designed to not permit unfair discrimination among LMMs.

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

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Market Makers will

be subject to quoting obligations which are similar to those at other options exchanges.<sup>44</sup> The obligations would apply to all of a Market Maker's registered options collectively to all appointed issues, rather than on an option-by-option basis and compliance with this obligation will be determined on a monthly basis. Further, Exchange believes that because this proposal establishes quoting compliance standards that are already in place on other options exchanges, the proposal will not diminish, and in fact may increase, market making activity on the Exchange and thereby enhance intermarket competition. Moreover, the proposed rule change will not impose any burden on intra-market competition because it will affect all Market Makers the same. LMMs will be subject to heightened quoting obligations as compared to other BX Market Makers. All market makers that desire to apply to become LMMs will be subject to the same review and scrutiny with respect to their LMM application and the ultimate assignment of options series.

The Exchange does not believe the proposed rule change will cause any unnecessary burden on intra-market competition because it provides all market participants that qualify as LMMs and meet the required criteria and fulfill the required obligations the opportunity to benefit from participation entitlements. The Exchange believes that the proposed rule change will promote competition among LMMs who desire to be assigned in options series and in turn promote trading activity on the Exchange to the benefit of the Exchange, its Members, and market participants.

The Exchange does not believe the proposed change will cause any unnecessary burden on inter-market competition because any qualifying LMM will be entitled to

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<sup>44</sup> See supra note 3.

receive participation entitlements on options series they are obligated to quote in under the Rules. In addition, the Exchange believes that the proposed rule change will in fact promote competition. The Exchange believes allowing LMMs to receive participation entitlements will promote trading activity on the Exchange because it will provide incentives to LMMs to quote in series which they are not obligated to do so, to the benefit of the Exchange, its Members, and market participants.

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 proposed rule change is, in part, based on NYSE MKT, BATS, Phlx and NYSE Arca Rules.<sup>45</sup>

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<sup>45</sup> The proposed BX Market Maker quoting obligation rules are based on NYSE Arca Rule 6.37B(c), NYSE MKT Rule 925.1NY(c), BATS Rule 22.6(d)(3) and Phlx Rule 1014. The 60% quoting obligations proposed herein for BX Market Makers are the same as those obligations on NYSE Arca and NYSE MKT. The proposal to require that quoting obligations apply to a Market Maker's appointed issues collectively is the same as BATS and Phlx Rules.

The proposed rules at Chapter VII, Section 13 are based on Phlx Rules 501, 505, 506 and 511. Phlx adopted Rule 501, in part, to require specialists to submit an application with certain information in a form prescribed by Phlx. Rule 501 applies to specialists units as well as individuals who will act as assistant specialists. Proposed part A (LMM Appointment) of Chapter VII, Section 13

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

Not applicable.

10. Advance 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.

5. Applicable portion of the rule text.

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applies to LMMs who are Option Participant firms. Only the applicable parts of Phlx Rule 501 were copied into the proposed rule. The references to the trading floor are inapplicable to BX, an electronic market as well as references to measures applicable to participants engaged in floor trading as evidenced in the difference in text in proposed Chapter VII, Section 13(C)(a). Phlx Rule 506 was copied in part into proposed part B (LMM Allocation Application) of Chapter VII, Section 13. BX did not include the allocation preclusion language of Phlx Rule 506 in the proposed BX Rule. Proposed part C (LMM Allocation) of Chapter VII, Section 13 was copied in significant part from Phlx Rule 511(b). Proposed Part D (LMM Allocation, Reallocation and Transfer of Issues) of Chapter VII, Section 13 was copied in part from Phlx Rule 505 to the extent the Phlx Rule relates to a firm versus an individual. Proposed Chapter VII, Section 14 is copied from NYSE Arca Rules 6.37A and 6.37B. References to trading crowds were eliminated as BX is an electronic market. The rule text in Chapter VII, Section 14(f)(3) is identical to firm quote language contained in BX Rules at Chapter VII, Section 6 relating to Market Maker quotations.

Exhibit 1

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-BX-2014-035)

Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing of Proposed Rule Change Relating to Market Maker Quoting Obligations and the Introduction of a Lead Market Maker

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 19, 2014, NASDAQ OMX BX, Inc. (“BX” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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 Substance of the Proposed Rule Change

The Exchange proposes to: (1) amend BX Market Maker quoting obligations; (2) adopt new BX Rules at Chapter VII, Section 13 and 14 to allow qualified Options Participants to act as a Lead Market Maker, or LMM, in one or more options classes; (3) revise priority rules to entitle LMMs participation entitlement; and (4) provide for a Public Customer priority overlay for the Price/Time Execution Algorithm.

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqomxbx.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

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

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 purpose of the proposed rule change is to amend the current BX Market Maker quoting obligations and adopt rules to permit BX Market Makers to act as Lead Market Makers, or LMMs, in one or more options classes, provided the LMM meets certain obligations and quoting requirements as provided for in the new proposed Exchange Rules. The Exchange proposes to provide assigned LMMs with certain participation entitlements. Finally, the Exchange proposes to provide Public Customers with priority when the Price/Time execution algorithm is in effect. The Exchange believes that these amendments, which will be described below in greater detail, will enhance competition on the Exchange by rewarding LMMs who meet certain obligations on BX.

BX Market Maker Quoting Obligations

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, Inc. (“NYSE Arca”) and NYSE MKT LLC (“NYSE MKT”). Specifically, BX proposes to reduce the quoting requirement for 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 quoting obligation will apply to all of a Market Maker’s registered options *collectively* on a daily basis, rather than on an option-by-option basis. This quoting obligation will be reviewed on a monthly basis, and allows the Exchange to review the Market Makers’ daily compliance in the aggregate and determine the appropriate disciplinary action for single or multiple failures to comply with the continuous quoting requirement during the month period. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve a Market Maker of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action

against a Market Maker for failing to meet the continuous quoting obligation each trading day. This is the same requirement as on other options exchanges.<sup>3</sup>

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. 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.

The Exchange believes that the amendments to Section 6(d)(i)(1) of Chapter VII, which would allow applying the quoting requirements for Market Makers collectively across all options classes, is a fair and more efficient way for the Exchange and market participants to evaluate compliance with the continuous quoting requirements. Applying the continuous quoting requirement collectively across all option classes rather than on an issue-by-issue basis is beneficial to Market Makers by providing some flexibility to choose which series in their appointed classes they will continuously quote--increasing the continuous quoting obligation in the series of one class to allow for a decrease in the

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<sup>3</sup> See NYSE Arca Rule 6.37B(c) and NYSE MKT Rule 925.1NY(c).

continuous quoting obligation in the series of another class. This flexibility does not, however, diminish the Market Maker's obligation to continuously quote a significant part of the trading day in a significant percentage of series. Flexibility is important for classes that have relatively few series and may prevent the Market Maker, in particular, from breaching the continuous quoting requirement when failing to meet the specified quote amount during the trading day (as proposed) in more than one series in an appointed class. However, this flexibility does not act to relieve the Market Maker of his continuous quoting obligations and does not, for example, relieve the Market Maker from providing liquidity in classes experiencing heightened volatility. The Exchange provides in the proposed rule that determining compliance with the continuous quoting requirement on a monthly basis will not relieve a Market Maker of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against a Market Maker for failing to meet the continuous quoting obligation each trading day. The Exchange believes that the balance between the benefits provided to Market Makers and the obligations imposed upon Market Makers by the proposed rule change is appropriate.

The Exchange believes that the proposal will not diminish, and in fact may increase, market making activity on the Exchange, by establishing quoting compliance standards that are reasonable and are already in place on other options exchanges. By amending Section 6 of Chapter VII to state that quoting obligations apply to a Market Maker's appointed issues collectively, this proposal is similar to that of other options markets and puts the Exchange on an equal competitive footing.<sup>4</sup> Moreover, as discussed

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<sup>4</sup> The proposed rule text is, as noted, similar in all material respects to BATS

the Exchange believes that the proposal may increase market making activity on the Exchange by establishing quoting compliance standards that are reasonable and already in place on other options exchanges.

#### Lead Market Makers Allocations

Today on BX there are two types of Options Participants, Options Order Entry Firms and Options Market Makers. Options Order Entry Firms, or OEFs, are Options Participants who represent customer orders as agent on BX Options and non-Market Maker Participants conducting proprietary trading as principal. Options Market Makers are Options Participants registered with the Exchange as Options Market Makers in one or more listed options on BX.<sup>5</sup> BX may suspend or terminate any registration of an Options Market Maker when, in BX's judgment, the interests of a fair and orderly market are best served by such action.

To become an Options Market Maker, an Options Participant is required to register by filing a written application. BX does not place any limit on the number of entities that may become Options Market Makers. BX Options Market Makers are required to electronically engage in a course of dealing to enhance liquidity available on BX and to assist in the maintenance of fair and orderly markets.<sup>6</sup> Among other things,

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Exchange, Inc. ("BATS") Rule 22.6(d)(3) and NASDAQ OMX PHLX LLC ("Phlx") Rule 1014.

<sup>5</sup> See BX Options Rules at Chapter VII.

<sup>6</sup> Options Market Makers receive certain benefits for carrying out their duties. For example, a lender may extend credit to a broker-dealer without regard to the restrictions in Regulation T of the Board of governors of the Federal Reserve System if the credit is to be used to finance the broker-dealer's activities as market maker on a national securities exchange. Thus, an Options Market Maker has a corresponding obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis to justify this favorable treatment.

Options Market Makers must maintain minimum net capital in accordance with SEC and BX Options Rules. The Exchange is proposing herein that Options Market Makers must quote 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.<sup>7</sup> 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. Market Makers shall not be required to make two-sided markets pursuant to Section 5(a)(i) of Chapter VII in any Quarterly Option Series, adjusted option series, or 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,<sup>8</sup> or any series with an expiration of nine months or greater. However, a LMM may still receive a participation entitlement in such series if it elects to quote in such series and otherwise satisfies the requirements of Chapter VI, Section 10. 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 these calculations with respect to the affected quotes.<sup>9</sup> Options Market Makers must also comply with certain bid/ask

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<sup>7</sup> As noted herein, today BX Options Market Makers 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.

<sup>8</sup> 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.

<sup>9</sup> Substantial or continued failure by an Options Market Maker to meet any of its

differentials (quote spread parameters).<sup>10</sup> Options on equities (including Exchange-Traded Fund Shares), and on index options must be quoted with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid, including before and during the opening.<sup>11</sup> However, respecting in-the-money series where the market for the underlying security is wider than \$5, the bid/ask differential may be as wide as the quotation for the underlying security on the primary market.<sup>12</sup>

At this time, the Exchange is proposing a third type of Options Participant, an LMM. Approved BX Options Market Makers<sup>13</sup> may become an LMM in one or more listed options. Initial application(s) to become an LMM shall be in a form and/or format prescribed by the Exchange and shall include the following: (1) background information on the LMM including experience in trading options; (2) the LMM's clearing arrangements; (3) adequacy of capital; and (4) adherence to Exchange rules and ability to meet obligations of an LMM.<sup>14</sup> Subsequent applications shall be in a form and/or format prescribed by the Exchange and shall include the information requested therein, including, but not limited to, an account of the abilities and background of the applicant

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obligations and duties, will subject the Options Market Maker to disciplinary action, suspension, or revocation of the Options Market Maker's registration in one or more options series.

<sup>10</sup> See BX Options Rules at Chapter VII, Section 6.

<sup>11</sup> Id.

<sup>12</sup> Id.

<sup>13</sup> See Chapter VII, Section 2.

<sup>14</sup> See proposed BX Options Rules at Chapter VII, Section 13(A)(b).

as well as any other special requirements that the Exchange may require.<sup>15</sup> Once an applicant is approved by the Exchange as an LMM, any material change in capital shall be reported in writing to the Exchange within two business days after the change. BX will not place any limit on the number of entities that may become LMMs, however the Exchange notes that there will only be one LMM per class.

When an options class is to be allocated or reallocated by the Exchange, the Exchange will solicit applications from all eligible LMMs. If the Exchange determines that special qualifications should be sought in the successful applicant, it shall indicate such desired qualifications in the notice.<sup>16</sup>

Further, the Exchange proposes to require an allocation application to be submitted in writing to the Exchange's designated staff and shall include, at a minimum, the name and background of the LMM, the LMM's experience and capitalization demonstrating an ability to trade the particular options class sought, and any other reasons why the LMM believes it should be assigned or allocated the security. In addition, the Exchange may also require that the application include other information such as system acceptance/execution levels and guarantees. The Exchange may re-solicit applications for any reason, including if it determines that its initial solicitation resulted in an insufficient number of applicants.<sup>17</sup>

Allocation decisions and automatic allocations shall be communicated in writing to Exchange members. Once the LMM is allocated an issue, such LMM shall

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<sup>15</sup> See proposed BX Options Rules at Chapter VII, Section 13(A)(c).

<sup>16</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(a).

<sup>17</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(b).

immediately notify the Exchange in writing of any change to the respective system acceptance/execution levels or any other material change in the application for any assigned issue. If an LMM seeks to withdraw from allocation in a security, it should so notify the Exchange at least one business day prior to the desired effective date of such withdrawal.<sup>18</sup>

Options on Related Securities shall be automatically allocated to the LMM that is already the LMM in Currently Allocated Securities (as defined hereafter). Only one LMM may be allocated to an options class. The Exchange is defining the term “Related Securities” for purpose of Chapter VII, Section 13 as follows: “Related Securities means, but is not limited to: securities of a partially or wholly owned subsidiary; securities that are convertible into the securities of the issuer; warrants on securities of the issuer; securities issued in connection with a name change; securities issued in a reverse stock split; contingent value rights; ”tracking” securities designed to track the performance of the underlying security or corporate affiliate thereof; securities created in connection with the merger or acquisition of one or more companies; securities created in connection with a “spin-off” transaction; convertible on non-convertible senior securities; and securities into which a listed security is convertible, where such Related Securities emanate from or are related to securities underlying options that are currently allocated to a LMM on the Exchange (“Currently Allocated Options”). The term Related Securities does not include Exchange Traded Funds.<sup>19</sup>

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<sup>18</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(c)(d) and (e).

<sup>19</sup> See proposed BX Options Rules at Chapter VII, Section 13(B)(f).

The Exchange shall allocate new options classes, or reallocate existing options classes to applicants based on the results of such factors as the Exchange deems appropriate. Among the factors that the Exchange may consider in making such decisions are: the number and type of securities in which applicants are currently registered; the capital and other resources of the applicant; recent allocation decisions within the past eighteen months; the desirability of encouraging the entry of new LMMs into the Exchange's market; order flow commitments; any prior transfers of LMM privileges by the applicant and the reasons therefore and such policies as the Board instructs the Exchange to follow in allocating or reallocating securities. The Exchange may also consider: quality of markets data; observance of ethical standards and administrative responsibilities. Solely with respect to options class allocations or reallocations, past or contemplated voluntary delisting of options by LMMs, done in the best interest of the Exchange, will not be viewed negatively by the Exchange in making allocation and reallocation decisions. The Exchange is empowered to allocate option classes for a limited period of time or subject to such other terms and conditions as it deems appropriate.<sup>20</sup>

Requests to allocate or transfer allocation, or transfer of an options class request must be made in writing to the Exchange and such transfer may only be made to an approved LMM. The LMM shall be assigned to an options class for a period defined by the Exchange. The Exchange will communicate such period in solicitation applications

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<sup>20</sup> See proposed BX Options Rules at Chapter VII, Section 13(C).

(notices). The Exchange may re-allocate an options class after the defined period has expired.<sup>21</sup>

The proposed rules relating to the appointment of LMMs and the allocation of option series are similar to rules currently in place on NASDAQ OMX PHLX LLC (“Phlx”) with respect to its appointment of specialists.<sup>22</sup>

#### LMM Obligations and Quotations

The Exchange also requires that LMM transactions should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and no LMM should enter into transactions or make bids or offers that are inconsistent with such a course of dealings.<sup>23</sup> Further, with respect to each class of options in his or her appointment, an LMM is expected to engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class. Without limiting the foregoing, an LMM is expected to perform the following activities in the course of maintaining a fair and orderly market pursuant to proposed Chapter VII, Section 14(b): (i) to compete with other Market Makers to improve the market in all series of options classes to which the LMM is appointed; (ii) to make markets that will be

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<sup>21</sup> See proposed BX Options Rules at Chapter VII, Section 13(D).

<sup>22</sup> See Phlx Rules 501, 505, 506 and 511.

<sup>23</sup> See proposed BX Options Rules at Chapter VII, Section 14(a).

honored for the number of contracts entered into the Trading System<sup>24</sup> in all series of options classes within the LMM's appointment; (iii) to update market quotations in response to changed market conditions in all series of options classes within the LMM's appointment; (iv) options traded on the Trading System may be quoted with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid; and . (v) BX Regulation may establish quote width differences other than as provided in subparagraph (iv) for one or more options series. In the event the bid/ask differential in the underlying security is greater than the bid/ask differential set forth in subsection (b)(iv)-(v) of Section 14 the permissible price differential for any in-the-money option series may be identical to those in the underlying security market. In the case of the at-the-money and out-of-the-money series, BX Regulation may waive the requirements of subsections (b)(iv)-(v) of Section 14 on a case-by-case basis when the bid/ask differential for the underlying security is greater than .50. In such instances, the bid/ask differentials for the at-the-money series and the out-of-the-money series may be half as wide as the bid/ask differential in the underlying security in the primary market. Exemptions from subsections (b)(iv)-(v) are subject to Exchange review. BX Regulation must file a report with BX operations setting forth the time and duration of such exemptive relief and the reasons therefore.<sup>25</sup>

With respect to unusual conditions, if the interest of maintaining a fair and orderly market so requires, BX Regulation may declare that unusual market conditions exist in a

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<sup>24</sup> See Chapter I, Section 1(62). The term “Trading System” or “System” means the automated trading system used by BX Options for the trading of options contracts.

<sup>25</sup> See proposed BX Options Rules at Chapter VII, Section 14(b).

particular issue and allow LMMs in that issue to make auction bids and offers with spread differentials of up to two times, or in exceptional circumstances, typically up to three times, the legal limits permitted under this Rule. In making such determinations to allow wider markets, BX Regulation should consider the following factors: (A) whether there is pending news, a news announcement or other special events; (B) whether the underlying security is trading outside of the bid or offer in such security then being disseminated; (C) whether Options Participants receive no response to orders placed to buy or sell the underlying security; and (D) whether a vendor quote feed is clearly stale or unreliable.<sup>26</sup> In the event that BX Regulation determines that unusual market conditions exist in any option, it will be the responsibility of BX Regulation to file a report with BX operations setting forth the relief granted for the unusual market conditions, the time and duration of such relief and the reasons therefore.

In classes of options other than those to which the LMM is appointed, LMMs should not engage in transactions for an account in which they have an interest that are disproportionate in relation to, or in derogation of, the performance of their obligations as specified in this Rule with respect to the classes in their appointment. Furthermore, LMMs should not: (1) individually or as a group, intentionally or unintentionally, dominate the market in option contracts of a particular class; and (2) effect purchases or sales on the Exchange except in a reasonable and orderly manner.<sup>27</sup>

LMMs are prohibited from the following: (1) any practice or procedure whereby LMMs trading any particular option issue determine by agreement the spreads or option

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<sup>26</sup> See proposed BX Options Rules at Chapter VII, Section 14(c).

<sup>27</sup> See proposed BX Options Rules at Chapter VII, Section 14(d).

prices at which they will trade that issue; and (2) any practice or procedure whereby LMMs trading any particular option issue determine by agreement the allocation of orders that may be executed in that issue.<sup>28</sup>

An LMM may enter quotations only in the issues included in its appointment. An LMM must provide continuous two-sided quotations throughout the trading day in its appointed issues for 90% of the time the Exchange is open for trading in each issue. Such quotations must meet the legal quote width requirements herein. These obligations will apply to all of the LMMs appointed issues collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis.<sup>29</sup> 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. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve an LMM of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against an LMM for failing to meet the continuous quoting obligation each trading day.

If a technical failure or limitation of a system of the Exchange prevents an LMM from maintaining, or prevents a LMM from communicating to the Exchange, timely and accurate electronic quotes in an issue, the duration of such failure shall not be considered in determining whether the LMM has satisfied the 90% quoting standard with respect to that option issue. The Exchange may consider other exceptions to this continuous

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<sup>28</sup> See proposed BX Options Rules at Chapter VII, Section 14(e).

<sup>29</sup> See proposed BX Options Rules at Chapter VII, Section 14(f).

electronic quote obligation based on demonstrated legal or regulatory requirements or other mitigating circumstances.<sup>30</sup> An LMM may be called upon by BX Regulation to submit a single quote or maintain continuous quotes in one or more series of an option issue within its appointment whenever, in the judgment of BX Regulation, it is necessary to do so in the interest of maintaining fair and orderly markets.<sup>31</sup>

An LMM shall be compelled to buy/sell a specified quantity of option contracts at the disseminated bid/offer pursuant to his obligations with respect to firm quotes. All quotes and orders entered into the System by Options Participants are firm under this Rule and Rule 602 of Regulation NMS under the Exchange Act (“SEC Rule 602”) for the number of contracts specified and according to the size requirements set forth herein. Market Maker bids and offers are not firm under this Rule and SEC Rule 602: (1) for the period prior to the Opening Cross; or (2) if any of the circumstances provided in paragraph (b)(3) or (c)(4) of SEC Rule 602 exist.<sup>32</sup> These obligations of this Rule shall not apply to LMMs with respect to adjusted option series, quarterly options series, or any series with a time to expiration of nine months or greater. For purposes of this Rule, an adjusted option series is an option series wherein, as a result of a corporate action by the issuer of the underlying security, one option contract in the series represents the delivery of other than 100 shares of underlying security.<sup>33</sup>

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<sup>30</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(1).

<sup>31</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(2).

<sup>32</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(3).

<sup>33</sup> See proposed BX Options Rules at Chapter VII, Section 14(f)(4).

These LMM obligations are based on rules of NYSE Arca.<sup>34</sup>

### Lead Market Maker Priority

The Exchange proposes to provide LMM participation entitlements in Chapter VI (Trading Systems) at Section 10, entitled “Book Processing.” Specifically, with respect to Size Pro-Rata executions, the Exchange would afford an LMM a participation entitlement if the LMM’s bid/offer is at the Exchange’s disseminated price and all Public Customer<sup>35</sup> orders have been fully executed.<sup>36</sup> The LMM shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. LMM participation entitlements will be considered after the opening process. The LMM participation entitlement is as follows: (1) A BX Options LMM shall receive the greater of: the LMM’s Size Pro-Rata share; 50% of remaining interest if there is one or no other Market Maker at that price; 40% of remaining interest if there are two other Market Makers at that price; or 30% of remaining interest if there are more than two other Market Makers at that price; or if rounding would result in an allocation of less than one contract, a BX Options LMM shall receive one contract. Rounding will be up or down to the nearest integer.

Orders for 5 contracts or fewer shall be allocated to the LMM. The Exchange will review this provision quarterly and will maintain the small order size at a level that will not allow orders of 5 contracts or less executed by the LMM to account for more than

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<sup>34</sup> See 6.37A and 6.37B of NYSE Arca, Inc.’s Rulebook.

<sup>35</sup> See Chapter I, Section 1(50). The term “Public Customer” means a person that is not a broker or dealer in securities.

<sup>36</sup> Price Improving Orders will retain price priority before an LMM participation entitlement is provided at the Exchange’s disseminated price. See Chapter VI, Sections 1(a)(6) and 7(b)(3)(B).

40% of the volume executed on the Exchange. After all Public Customer orders have been fully executed and LMM participation entitlements applied, if applicable, BX Options Market Makers shall have priority over all other Participant orders at the same price.

Several examples of the manner in which an LMM will be allocated pursuant to the Size Pro-Rata model follow below.

*Example Number 1:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B 1 contract offered at 1.10

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

Customer B trades 1 contract at 1.10

LMM trades 4 contracts at 1.10

*Example Number 2:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (3 contracts)

Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (30 contracts)

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

LMM trades 3 contracts at 1.10

MM1 trades 0 contracts at 1.10  $((10/40)*2)$  [rounded down based on normal pro-rata]

MM2 trades 1 contracts at 1.10  $((30/40)*2)$  [rounded down based on normal pro-rata]

MM1 then trades the 1 residual contract based on time

*Example # 3:*

ABBO = 1.00 – 1.10

BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

LMM: 1.00 bid (10 contracts) – 1.10 offer (15 contracts)

Customer A 5 contracts offered at 1.10

Firm 5 contracts offered at 1.10

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer B 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 5 contracts, Customer B trading 2 contracts, LMM trading 11 contracts  $(15/45*33)$  remaining), MM1 trading 14 contracts  $(20/45*33)$ , MM2 trading 7 contracts  $(10/45*33)$ , and then LMM based on time receiving an additional 1 lot.

LMM allocation would result in Customer A trading 5 contracts, Customer B trading 2 contracts, and LMM trading 40% of remaining 33 contracts = 13 (13.2 rounded down); then Size Pro-Rata for remaining with MM1 trading 13 contracts  $(20/30*20)$  and MM2 trading 6 contracts  $(10/30*20)$  and LMM trading an additional 1 lot based on time.

Pursuant to proposed Chapter VI, Section 10(1)(C)(2)(ii)(1), LMM allocation would prevail in this example because the LMM receives greater allocation.

*Example # 4:*

ABBO = 1.00 – 1.10

BX BBO = 1.00 – 1.10 comprised of the following in order of receipt

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer A 10 contracts offered at 1.10  
 Firm 15 offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B: 10 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 10 contracts, Customer B trading 10 contracts, LMM trading 6 contracts (10/30\*20 remaining rounded down), MM1 trading 6 contracts (10/30\*20), MM2 trading 6 contracts (10/30\*20), and then MM1 and LMM based on time each receiving an additional 1 lot.

LMM allocation would result in Customer A trading 10 contracts, Customer B trading 10 contracts, and LMM trading 40% of remaining 20 contracts = 8; then normal pro rata resumes with MM1 and MM2 each being allocated 6 contracts.

Pursuant to proposed Chapter VI, Section 10(1)(C)(2)(ii)(1), LMM allocation would prevail in this example because the LMM receives greater allocation.

*Example Number 5:*

ABBO = 1.00 – 1.10

BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 25 offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Market Maker 2: 1.00 bid (5 contracts) – 1.10 offer (10 contracts)

Market Maker 3 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer B trading 2 contracts, MM1 trading 6 contracts (10/60\*38), LMM trading 12 (20/60\*38), MM2 trading 6 contracts (10/60\*38), and MM3 trading 12 contracts (20/60\*38) and then MM1 and LMM each trading an additional 1 contract based on time.

LMM allocation would result in Customer B trading 2 contracts and LMM trading 30% of remaining 38 contracts = 11 (11.4 rounded down); then normal pro rata resumes and MM1 trades 6 contracts (10/40\*27), MM2 trades 6 (10/40\*27), and MM3 trades 13 contracts (20/40\*27) and MM1 and LMM each trade an additional 1 lot based on time.

Size Pro-Rata allocation would prevail because the LMM receives greater allocation that way pursuant to proposed Chapter VI, Section 10(1)(C)(2)(ii)(1).

With respect to Price/Time executions, the Exchange proposes to provide that the highest bid and lowest offer shall have priority except that Public Customer orders shall have priority over non-Public Customer orders at the same price. Today, Public Customer orders do not have priority over non-Public Customer orders at the same price. If there are two or more Public Customer orders for the same options series at the same price, priority shall be afforded to such Public Customer orders in the sequence in which they are received by the System. For purposes of this Rule, a Public Customer order does not include a Professional Order. Public Customer Priority is always in effect when Price/Time execution algorithm is in effect.<sup>37</sup> The Exchange is proposing to add a sentence to the rule text at Chapter VI, Section 10(1)(C)(1)(a) to state that Public Customer Priority is always in effect when the Price/Time execution algorithm is in

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<sup>37</sup> See proposed Chapter VI, Section 10(1)(C)(1)(a).

effect. This is a substantive change which will provide Public Customer orders with priority over non-Public Customer orders at the same price for executions under the Price/Time execution algorithm. Similar language is also being added to Chapter VI, Section 10(1)(C)(2)(i) to conform the Size Pro-Rata language for clarity. Public Customer priority has been in effect when the Size Pro-Rata execution algorithm has been in effect. This amendment to the Size Pro-Rata language seeks to clarify Public Customer priority with respect to that algorithm. The Public Customer priority overlay recognizes the unique status of customers in the marketplace and the role their orders play in price competition and adding depth to the marketplace.

The Exchange proposes that LMM participant entitlements may be in effect when the Public Customer Priority Overlay is also in effect. After all Public Customer orders have been fully executed, upon receipt of an order, provided the LMM's bid/offer is at the Exchange's disseminated price, the LMM will be afforded a participation entitlement.<sup>38</sup> The LMM shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. A BX Options LMM shall receive the greater of: (a) contracts the LMM would receive if the allocation was based on time priority with Public Customer priority; (b) 50% of remaining interest if there is one or no other Market Maker at that price; (c) 40% of remaining interest if there are two other Market Makers at that price; or (d) 30% of remaining interest if there are more than two other Market Makers at that price or if rounding would result in an allocation of less

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<sup>38</sup> Price Improving Orders will retain price priority before an LMM participation entitlement is provided at the Exchange's disseminated price. See Chapter VI, Sections 1(a)(6) and 7(b)(3)(B).

than one contract, a BX Options LMM shall receive one contract. Rounding will be up or down to the nearest integer.

Orders for 5 contracts or fewer shall be allocated to the LMM. The Exchange will review this provision quarterly and will maintain the small order size at a level that will not allow orders of 5 contracts or less executed by the LMM to account for more than 40% of the volume executed on the Exchange.

Several examples of the manner in which an LMM will be allocated pursuant to the Price/Time model follow below.

*Example Number 1:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer A: 5 contracts offered at 1.10  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Price/Time with Customer priority results in Customer A trading 5 contracts, Customer B trading 2 contracts, Market Maker 1 trading 10 contracts, LMM trading 20 contracts, and Firm trading 3 contracts

LMM allocation would result in Customer A trading 5 contracts, Customer B trading 2 contracts, and LMM trading 40% of remaining 33 contracts = 13 (13.2 rounded down); then normal price time resumes and Market Maker1 trades 10 contracts, Firm trades 5 contracts, and LMM trades an additional 5 contracts

Price/Time with Customer priority would prevail because LMM allocation results in a greater allocation pursuant to proposed Chapter VI, Section 10(1)(a).

*Example Number 2:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer A 10 contracts offered at 1.10  
 Firm 15 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B 10 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Price/Time with Customer priority results in Customer A trading 10 contracts, Customer B trading 10 contracts, Market Maker 1 trading 10 contracts, Firm trading 10 contracts

LMM allocation would result in Customer A trading 10 contracts, Customer B trading 10 contracts, and LMM trading 40% of remaining 20 contracts = 8; then Price/Time resumes and Market Maker 1 trades 10 contracts and Firm trades 2 contracts

LMM allocation would prevail because the LMM receives a greater allocation with this calculation pursuant to proposed Chapter VI, Section 10(1)(C)(1)(b)(1).

*Example Number 3:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 25 contracts offered at 1.10  
 LMM 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Customer B 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Price/Time with Customer priority results in Customer B trading 2 contracts, Market Maker 1 trading 10 contracts, Firm trading 25 contracts, and LMM trading 3 contracts

LMM allocation would results in Customer B trading 2 contracts and LMM trading 50% of remaining 38 contracts = 19; then normal price time resumes and MM1 trades 10 contracts and Firm trades 9 contracts

LMM allocation would prevail because the LMM receives a greater allocation with this calculation pursuant to proposed Chapter VI, Section 10(1)(C)(1)(b)(1).

*Example Number 4:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B 1 contract offered at 1.10

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

Customer B trades 1 contract at 1.10  
 LMM trades 4 contracts at 1.10

*Example Number 5:*

ABBO = 1.00 – 1.10  
 BX BBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Market Maker 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer A: 1 contract offered at 1.10  
 Firm 5 contracts offered at 1.10  
 LMM: 1.00 bid (10 contracts) – 1.10 offer (3 contracts)  
 Market Maker 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)  
 Customer B 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 5 contracts

Allocated as follows:

Customer A trades 1 contract at 1.10  
Customer B trades 2 contracts at 1.10  
LMM trades 2 contracts at 1.10

The Exchange desires to implement this rule change by rolling out the rule amendments on an option-by-option basis over a period of time. The Exchange would issue Options Trader Alerts in advance to inform market participants which symbols will be implemented on which dates.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>39</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>40</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. 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.

The Exchange believes that requiring Market Makers to provide continuous two-sided quotations 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 continues

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<sup>39</sup> 15 U.S.C. 78f(b).

<sup>40</sup> 15 U.S.C. 78f(b)(5).

to promote just and equitable principles of trade, and to foster cooperation and coordination with persons engaged in facilitating transactions in securities. Further, the Exchange would apply the quoting requirement to all of a Market Maker's registered options collectively to all appointed issues, rather than on an option-by-option basis and compliance with this obligation will be determined on a monthly basis.

The proposal supports the quality of the Exchange's market by helping to ensure that Market Makers will continue to be obligated to quote in series when necessary. Ultimately, the benefit the proposed rule change confers upon Market Makers is offset by the continued responsibilities to provide significant liquidity to the market to the benefit of market participants. While under the proposal there are quoting requirements changes, the Exchange does not believe that these changes reduce the overall obligations applicable to Market Makers.<sup>41</sup> Moreover, the Exchange believes that the proposal may increase market making activity on the Exchange and the quality of the Exchange's market by establishing quoting compliance standards that are reasonable and already in place on other options exchanges.<sup>42</sup>

The proposed rule change also protects investors and the public interest by creating more uniformity and consistency among the Exchange's rules related to Market Maker quoting obligations. Providing Market Makers with flexibility by providing the continuous quoting obligation collectively across all option classes will not diminish the Market Makers' obligation to continuously quote a significant part of the trading day in a

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<sup>41</sup> In this respect, the Exchange notes that such Market Makers are subject to many obligations aside from quoting, including, for example, the obligation to maintain a fair and orderly market in their appointed classes, and the obligation to conduct the opening and enter continuous quotations in all of the series of their appointed options classes within maximum spread requirements.

<sup>42</sup> See supra note 4.

significant percentage of series. Additionally, with respect to compliance standards, the Exchange believes that adopting the proposed standards will enhance compliance efforts by Market Makers and the Exchange, and are consistent with requirements currently in place on other options exchanges (*e.g.* BATS Rule 22.6(d)(3) and Phlx Rule 1014). The proposal ensures that compliance standards for continuous quoting, in particular regarding quoting obligations applying to all of a Market Maker's appointed issues collectively, will be the same on the Exchange as on other options exchanges. The Exchange believes that the proposal will not diminish and in fact may increase, market making activity on the Exchange by establishing quoting compliance standards that are reasonable and already in place on other options exchanges.

The proposed rules relating to LMM allocations seek to establish and promote just and equitable principles of trade by requiring each market maker who desires to be an LMM to submit an application to the Exchange providing certain basic information and other information as necessary. The solicitation process is intended to provide all LMMs an opportunity to seek allocations by requiring allocation applications to be submitted in writing to the Exchange with certain information. The Exchange intends to foster cooperation and coordination with LMMs by requiring information concerning the LMM's experience and capitalization and other information to ensure that an LMM is qualified when allocated option series. LMMs would be required to update information accordingly once they are assigned in an option series.

Exchange staff seeks to allocate option series by considering a number of factors including but not limited to, the number and type of securities in which applicants are currently registered; the capital and other resources of the applicant; recent allocation

decisions within the past eighteen months; the desirability of encouraging the entry of new LMMs into the Exchange's market; order flow commitments; any prior transfers of LMM privileges by the applicant and the reasons therefore; quality of markets data; and observance of ethical standards and administrative responsibilities and such policies as the Board instructs the Exchange to follow in allocating or reallocating securities. These factors are intended to assist the Exchange in determining which LMMs qualify for allocations and the LMM's ability to meet its obligations. The process of allocating securities considers such factors to protect investors and the public interest by allocating to qualified and responsible Options Participants. Further, an LMM may be called upon by BX Regulation to submit a single quote or maintain continuous quotes in one or more series of an option issue within its appointment whenever, in the judgment of BX Regulation, it is necessary to do so in the interest of maintaining fair and orderly markets. An LMM will be compelled to buy/sell a specified quantity of option contracts at the disseminated bid/offer pursuant to his obligations with respect to firm quotes.

With respect to an LMM's obligations, the Exchange would require LMMs be subject to heightened standards as compared to other market makers. An LMM must provide continuous two-sided quotations throughout the trading day in its appointed issues for 90% of the time the Exchange is open for trading in each issue. Such quotations must meet the legal quote width requirements herein. These obligations will apply to all of the LMMs appointed issues collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis. 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. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve an LMM of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against an LMM for failing to meet the continuous quoting obligation each trading day.

LMM's transactions should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and no LMM should enter into transactions or make bids or offers that are inconsistent with such a course of dealings. An LMM is expected to engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class. The Exchange will obligate an LMM to certain conduct including: (1) to compete with other LMMs to improve the market in all series of options classes to which the LMM is appointed; (2) to make markets that will be honored for the number of contracts entered into the Trading System in all series of options classes within the LMM's appointment; (3) to update market quotations in response to changed market conditions in all series of options classes within the LMM's appointment; (4) to quote with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid; (5) to establish quote width differences other than as provided in subparagraph (4) for one or more options series; (6) and certain permissible price differentials.

With respect to classes of option contracts outside of their appointment, LMMs will not be permitted to engage in transactions for an account in which they have an interest that are disproportionate in relation to, or in derogation of, the performance of their obligations as specified in this Rule with respect to the classes in their appointment. LMMs are also prohibited from entering into certain agreements that may undermine the LMMs obligations.

The Exchange believes that the obligations set forth for LMMs in its proposed rules will promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in facilitating transactions in securities, and, in general, to protect investors and the public interest.

The Exchange believes that offering LMMs participation entitlements promotes just and equitable principles of trade because LMMs will be held to a higher standard as compared to other market participants including Market Makers. A Market Maker would be required, pursuant to this proposal, to quote 60% of the trading day. LMMs are being held to a higher obligation and therefore are being rewarded with participation entitlements. Similar to Market Makers, LMMs add value through continuous quoting<sup>43</sup> and the commitment of capital.

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<sup>43</sup> Pursuant to Chapter VII (Market Participants), Section 5 (Obligations of Market Makers), in registering as a market maker, an Options Participant commits himself to various obligations. Transactions of a Market Maker in its market making capacity must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and Market Makers should not make bids or offers or enter into transactions that are inconsistent with such course of dealings. See Chapter VII, Section 5. Further, all Market Makers are designated as specialists on BX for all purposes under the Act or rules thereunder. See Chapter VII, Section 2.

In addition, the LMM quoting requirements promote liquidity and continuity in the marketplace in requiring LMMs to be held to a higher standard of quoting. The Exchange also believes that the proposed rule change supports the quality of the Exchange's markets because it maintains the quoting obligations of Market Makers as LMMs at 90%. LMM transactions must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. Accordingly, the proposed rule change supports the quality of the Exchange's trading markets by helping to ensure that LMMs will be required to meet a higher quoting standard in order to reap the benefits of the participation entitlements. The Exchange believes this proposed change to offer participation entitlements to LMMs is offset by LMMs' continued responsibilities to provide significant liquidity to the market to the benefit of market participants.

The Exchange's proposal to add a sentence to the rule text at Chapter VI, Section 10(1)(C)(1)(a) to state that Public Customer Priority is always in effect when the Price/Time execution algorithm is in effect and also add language to Chapter VI, Section 10(1)(C)(2)(i) to conform the Size Pro-Rata language for clarity recognizes the unique status of customers in the marketplace and the role their orders play in price competition and adding depth to the marketplace. The Exchange believes that the Public Customer priority overlay is designed to promote just and equitable principles of trade and to protect investors and the public interest.

The proposed rule change also removes impediments to and allows for a free and open market, while protecting investors, by promoting transparency regarding LMMs'

obligations and benefits in the Exchange Rules. In addition, the Exchange believes that the proposed rule change is designed to not permit unfair discrimination among LMMs.

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

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Market Makers will be subject to quoting obligations which are similar to those at other options exchanges.<sup>44</sup> The obligations would apply to all of a Market Maker's registered options collectively to all appointed issues, rather than on an option-by-option basis and compliance with this obligation will be determined on a monthly basis. Further, Exchange believes that because this proposal establishes quoting compliance standards that are already in place on other options exchanges, the proposal will not diminish, and in fact may increase, market making activity on the Exchange and thereby enhance intermarket competition. Moreover, the proposed rule change will not impose any burden on intra-market competition because it will affect all Market Makers the same. LMMs will be subject to heightened quoting obligations as compared to other BX Market Makers. All market makers that desire to apply to become LMMs will be subject to the same review and scrutiny with respect to their LMM application and the ultimate assignment of options series.

The Exchange does not believe the proposed rule change will cause any unnecessary burden on intra-market competition because it provides all market participants that qualify as LMMs and meet the required criteria and fulfill the required obligations the opportunity to benefit from participation entitlements. The Exchange

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<sup>44</sup> See supra note 3.

believes that the proposed rule change will promote competition among LMMs who desire to be assigned in options series and in turn promote trading activity on the Exchange to the benefit of the Exchange, its Members, and market participants.

The Exchange does not believe the proposed change will cause any unnecessary burden on inter-market competition because any qualifying LMM will be entitled to receive participation entitlements on options series they are obligated to quote in under the Rules. In addition, the Exchange believes that the proposed rule change will in fact promote competition. The Exchange believes allowing LMMs to receive participation entitlements will promote trading activity on the Exchange because it will provide incentives to LMMs to quote in series which they are not obligated to do so, to the benefit of the Exchange, its Members, and market participants.

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](mailto:rule-comments@sec.gov). Please include File Number SR-BX-2014-035 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-BX-2014-035. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on

official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-BX-2014-035 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>45</sup>

Kevin M O'Neill  
Deputy Secretary

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<sup>45</sup> 17 CFR 200.30-3(a)(12).

**Exhibit 5**

*New text is underlined; deleted text is in brackets.*

**NASDAQ OMX BX Rules**

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**Options Rules**

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**Chapter VI Trading Systems**

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**Sec. 10 Book Processing**

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

**(1) Execution Algorithm** - The Exchange will determine to apply, for each option, one of the following execution algorithms described in paragraphs (A) or (B). The Exchange will issue an Options Alert specifying which execution algorithm will govern which options any time it is modified.

**(A) Price/Time** - The System shall execute trading interest within the System in price/time priority, meaning it will execute all trading interest at the best price level within the System before executing trading interest at the next best price. Within each price level, if there are two or more quotes or orders at the best price, trading interest will be executed in time priority.

**(B) Size Pro-Rata** - The System shall execute trading interest within the System in price priority, meaning it will execute all trading interest at the best price level within the System before executing trading interest at the next best price. Within each price level, if there are two or more quotes or orders at the best price, trading interest will be executed 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. If the result is not a whole number, it will be rounded down to the nearest whole number. If there are residual contracts remaining after rounding, such contracts will be distributed one contract at a time to the remaining Participants in time priority.

**(C) Priority Overlays**

**(1) Priority Overlays Applicable to Price/Time Execution Algorithm:** the Exchange may apply the following designated Participant priority overlays, when the Price/Time execution algorithm is in effect:

(a) Public Customer Priority: the highest bid and lowest offer shall have priority except that Public Customer orders shall have priority over non-Public Customer orders at the same price. If there are two or more Public Customer orders for the same options series at the same price, priority shall be afforded to such Public

Customer orders in the sequence in which they are received by the System. For purposes of this Rule, a Public Customer order does not include a Professional Order. Public Customer Priority is always in effect when the Price/Time execution algorithm is in effect.

(b) Lead Market Maker (“LMM”) Priority: An LMM may be assigned by the Exchange in each option class in accordance with Chapter VII, Section 13. LMM participant entitlements shall only be in effect when the Public Customer Priority Overlay is also in effect. After all Public Customer orders have been fully executed, upon receipt of an order, provided the LMM’s bid/offer is at the Exchange’s disseminated price, the LMM will be afforded a participation entitlement. The LMM shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. LMM participation entitlements will be considered after the opening process. The LMM participation entitlement is as follows:

(1) A BX Options LMM shall receive the greater of:

(a) contracts the LMM would receive if the allocation was based on time priority pursuant to subparagraph (1)(a) above with Public Customer priority;

(b) 50% of remaining interest if there is one or no other Market Maker at that price;

(c) 40% of remaining interest if there is two other Market Makers at that price; or

(d) 30% of remaining interest if there are more than two other Market Makers at that price.

If rounding would result in an allocation of less than one contract, a BX Options LMM shall receive one contract. Rounding will be up or down to the nearest integer.

(2) Orders for 5 contracts or fewer shall be allocated to the LMM. The Exchange will review this provision quarterly and will maintain the small order size at a level that will not allow orders of 5 contracts or less executed by the LMM to account for more than 40% of the volume executed on the Exchange.

If there are contracts remaining after all LMM interest has been fully executed, such contracts shall be executed based on the Price/Time execution algorithm.

(2) Priority Overlays Applicable to Size Pro-Rata Execution Algorithm: the Exchange will apply the following designated Participant priority overlays, which are always in effect when the Size Pro-Rata execution algorithm is in effect.

(i) Public Customer Priority: the highest bid and lowest offer shall have priority except that Public Customer orders shall have priority over non-Public Customer orders at the same price. If there are two or more Public Customer orders for the same options series at the same price, priority shall be afforded to such Public Customer orders in the sequence in which they are received by the System. For purposes of this Rule, a Public Customer order does not include a Professional Order. Public Customer Priority is always in effect when Size Pro-Rata execution algorithm is in effect.

(ii) LMM Priority: An LMM may be assigned by the Exchange in each option class in accordance with Chapter VII, Section 13. After all Public Customer orders have been fully executed, upon receipt of an order, provided the LMM's bid/offer is at the Exchange's disseminated price, the LMM will be afforded a participation entitlement. The LMM shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. LMM participation entitlements will be considered after the opening process. The LMM participation entitlement is as follows:

(1) A BX Options LMM shall receive the greater of:

(a) the LMM's Size Pro-Rata share under (1)(C)(2)(iii) below;

(b) 50% of remaining interest if there is one or no other Market Maker at that price;

(c) 40% of remaining interest if there are two other Market Makers at that price; or

(d) 30% of remaining interest if there are more than two other Market Makers at that price.

If rounding would result in an allocation of less than one contract, a BX Options LMM shall receive one contract. Rounding will be up or down to the nearest integer.

(2) Orders for 5 contracts or fewer shall be allocated to the LMM. The Exchange will review this provision quarterly and will maintain the small order size at a level that will not allow orders of 5 contracts or less executed by the LMM to account for more than 40% of the volume executed on the Exchange.

(iii) Market Maker Priority: After all Public Customer orders have been fully executed and LMM participation entitlements applied, if applicable, BX Options Market Makers shall have priority over all other Participant orders at the same price. If there are two or more BX Options Market Maker quotes and orders for the same options series at the same

price, those shall be executed based on the Size Pro-Rata execution algorithm. If there are contracts remaining after all Market Maker interest has been fully executed, such contracts shall be executed based on the Size Pro-Rata execution algorithm.

(2) - (7) No Change.

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## 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 90]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 [90]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 to all appointed issues, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve a Market Maker of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against a Market Maker for failing to meet the continuous quoting obligation each trading day.

2) and 3) No Change

ii. - iii. No change.

(e) No change.

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### Sec 13. Lead Market Makers Allocations

#### A. LMM Appointment

(a) Approved BX Options Market Makers may become LMMs. Only one LMM may be allocated to an options class.

(b) Initial application(s) to become an LMM shall be in a form and/or format prescribed by the Exchange and shall include the following: (1) background information on the prospective LMM including experience in trading options; (2) the LMM's clearing arrangements; (3) adequacy of capital; and (4) adherence to Exchange rules and ability to meet obligations of an LMM.

(c) Subsequent applications shall be in a form and/or format prescribed by the Exchange and shall include the information requested therein, including, but not limited to, an account of the abilities and background of the applicant as well as any other special requirements that the Exchange may require.

(d) Once an applicant is approved by the Exchange as an LMM, any material change in capital shall be reported in writing to the Exchange and in no circumstances shall be reported more than two business days after the change.

#### B. LMM Allocation Application

(a) When an options class is to be allocated or reallocated by the Exchange, the Exchange will solicit applications from all eligible LMMs. If the Exchange determines that special qualifications should be sought in the successful applicant, it shall indicate such desired qualifications in the notice.

(b) An allocation application shall be submitted in writing to the Exchange's designated staff and shall include, at a minimum, the name and background of the LMM, the LMM's experience and capitalization demonstrating an ability to trade the particular options class sought, and any other reasons why the LMM believes it should be assigned or allocated the security. In addition, the Exchange may also require that the application include other information such as system acceptance/execution levels and guarantees. The Exchange may re-solicit applications for any reason, including if it determines that its initial solicitation resulted in an insufficient number of applicants.

(c) Allocation decisions and automatic allocations, as noted in subsection (g) below, shall be communicated in writing to Exchange members.

(d) Once the LMM is allocated an issue, such LMM shall immediately notify the Exchange in writing any change to the respective system acceptance/execution levels or any other material change in the application for any assigned issue.

(e) If an LMM seeks to withdraw from allocation in a security, it should so notify the Exchange at least one business day prior to the desired effective date of such withdrawal.

(f) Definition of Related Securities. For purposes of this Rule, the term "Related Securities" means, but is not limited to: securities of a partially or wholly owned subsidiary; securities

that are convertible into the securities of the issuer; warrants on securities of the issuer; securities issued in connection with a name change; securities issued in a reverse stock split; contingent value rights; "tracking" securities designed to track the performance of the underlying security or corporate affiliate thereof; securities created in connection with the merger or acquisition of one or more companies; securities created in connection with a "spin-off" transaction; convertible on non-convertible senior securities; and securities into which a listed security is convertible, where such Related Securities emanate from or are related to securities underlying options that are currently allocated to a LMM on the Exchange ("Currently Allocated Options"). The term Related Securities does not include Exchange Traded Funds.

(g) Allocation of Options on Related Securities. Options on Related Securities ("Related Options") shall be automatically allocated to the LMM that is already the LMM in Currently Allocated Options.

#### C. LMM Allocation

(a) Allocations. The Exchange shall allocate new options classes, or reallocate existing options classes to applicants based on the results of such factors as the Exchange deems appropriate. Among the factors that the Exchange may consider in making such decisions are: the number and type of securities in which applicants are currently registered; the capital and other resources of the applicant; recent allocation decisions within the past eighteen months; the desirability of encouraging the entry of new LMMs into the Exchange's market; order flow commitments; any prior transfers of LMM privileges by the applicant and the reasons therefore and such policies as the Board instructs the Exchange to follow in allocating or reallocating securities. The Exchange may also consider: quality of markets data; and observance of ethical standards and administrative responsibilities. Solely with respect to options class allocations or reallocations, past or contemplated voluntary delisting of options classes by LMMs, done in the best interest of the Exchange, will not be viewed negatively by the Exchange in making allocation and reallocation decisions. The Exchange is empowered to allocate option classes for a limited period of time or subject to such other terms and conditions as it deems appropriate.

#### D. LMM Allocation, Reallocation and Transfer of Issues

Requests to allocate or transfer allocation or transfer of an options class request must be made in writing to the Exchange and such transfer may only be made to an approved LMM. The LMM shall be assigned LMM to an options class for a period defined by the Exchange. The Exchange will communicate such period in solicitation applications (notices) pursuant to Section B (LMM Allocation Application) herein. The Exchange may re-allocate an options class after the defined period has expired.

### **Sec. 14. LMM Obligations and Quotations**

(a) General. Transactions of an LMM should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and no LMM

should enter into transactions or make bids or offers that are inconsistent with such a course of dealings.

(b) *Obligations in Appointed Classes.* With respect to each class of options in his or her appointment, an LMM is expected to engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class. Without limiting the foregoing, an LMM is expected to perform the following activities in the course of maintaining a fair and orderly market.

(i) To compete with other LMMs and Market Makers to improve the market in all series of options classes to which the LMM is appointed.

(ii) To make markets that will be honored for the number of contracts entered into the Trading System in all series of options classes within the LMM's appointment.

(iii) To update market quotations in response to changed market conditions in all series of options classes within the LMM's appointment.

(iv) Options traded on the Trading System may be quoted with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid.

(v) BX Regulation may establish quote width differences other than as provided in subparagraph (iv) for one or more options series.

(vi) In the event the bid/ask differential in the underlying security is greater than the bid/ask differential set forth in subsections (b)(iv)-(v), the permissible price differential for any in-the-money option series may be identical to those in the underlying security market. In the case of the at-the-money and out-of-the-money series, BX Regulation may waive the requirements of subsections (b)(iv)-(v) on a case-by-case basis when the bid/ask differential for the underlying security is greater than .50. In such instances, the bid/ask differentials for the at-the-money series and the out-of-the-money series may be half as wide as the bid/ask differential in the underlying security in the primary market. Exemptions from subsections (b)(iv)-(v) are subject to Exchange review. BX Regulation must file a report with BX operations setting forth the time and duration of such exemptive relief and the reasons therefore.

(c) *Unusual Conditions - Opening Auction.* If the interest of maintaining a fair and orderly market so requires, BX Regulation may declare that unusual market conditions exist in a particular issue and allow LMMs in that issue to make auction bids and offers with spread differentials of up to two times, or in exceptional circumstances, up to three times, the legal limits permitted under this Rule. In making such determinations to allow wider markets, BX Regulation should consider the following factors: (A) whether there is pending news, a news announcement or other special events; (B) whether the

underlying security is trading outside of the bid or offer in such security then being disseminated; (C) whether Options Participants receive no response to orders placed to buy or sell the underlying security; and (D) whether a vendor quote feed is clearly stale or unreliable.

(i) In the event that BX Regulation determines that unusual market conditions exist in any option, it will be the responsibility of BX Regulation to file a report with Exchange Operations setting forth the relief granted for the unusual market conditions, the time and duration of such relief and the reasons therefore.

(d) *In Classes of Option Contracts Other Than Those to Which Appointed.* With respect to classes of option contracts outside of their appointment, LMMs should not engage in transactions for an account in which they have an interest that are disproportionate in relation to, or in derogation of, the performance of their obligations as specified in this Rule with respect to the classes in their appointment. Furthermore, LMMs should not:

(i) Individually or as a group, intentionally or unintentionally, dominate the market in option contracts of a particular class; and

(ii) Effect purchases or sales on the Exchange except in a reasonable and orderly manner.

(e) *Prohibited Practices and Procedures.*

(i) Any practice or procedure whereby LMMs trading any particular option issue determine by agreement the spreads or option prices at which they will trade that issue is prohibited.

(ii) Any practice or procedure whereby LMMs trading any particular option issue determine by agreement the allocation of orders that may be executed in that issue is prohibited.

(f) *LMM Quotations.* An LMM may enter quotations only in the issues included in its appointment.

(1) An LMM must provide continuous two-sided quotations throughout the trading day in its appointed issues for 90% of the time the Exchange is open for trading in each issue. Such quotations must meet the legal quote width requirements herein. These obligations will apply to all of the LMMs appointed issues collectively, rather than on an option-by-option basis. Compliance with this obligation will be determined on a monthly basis. 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. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve an LMM of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against an LMM for failing to meet the continuous quoting obligation each trading day.

(i) If a technical failure or limitation of a system of the Exchange prevents a LMM from maintaining, or prevents a LMM from communicating to the Exchange, timely and accurate electronic quotes in an issue, the duration of such failure shall not be considered in determining whether the LMM has satisfied the 90% quoting standard with respect to that option issue. The Exchange may consider other exceptions to this continuous electronic quote obligation based on demonstrated legal or regulatory requirements or other mitigating circumstances.

(2) Required Submission of Quotations. An LMM may be called upon by BX Regulation to submit a single quote or maintain continuous quotes in one or more series of an option issue within its appointment whenever, in the judgment of BX Regulation, it is necessary to do so in the interest of maintaining fair and orderly markets.

(3) Firm Quotes. An LMM shall be compelled to buy/sell a specified quantity of option contracts at the disseminated bid/offer pursuant to his obligations with respect to firm quotes.

i. All quotes and orders entered into the System by Options Participants are firm under this Rule and Rule 602 of Regulation NMS under the Exchange Act (“SEC Rule 602”) for the number of contracts specified and according to the size requirements set forth herein.

ii. Market Maker bids and offers are not firm under this Rule and SEC Rule 602:

(1) for the period prior to the Opening Cross; or

(2) if any of the circumstances provided in paragraph (b)(3) or (c)(4) of SEC Rule 602 exist.

(4) The obligations set forth in subsection (f) of this Rule shall not apply to LMMs with respect to Quarterly Options Series, adjusted option series, or any series with a time to expiration of nine months or greater. For purposes of this Rule, an adjusted option series is an option series wherein, as a result of a corporate action by the issuer of the underlying security, one option contract in the series represents the delivery of other than 100 shares of underlying security. However, a LMM may still receive a participation entitlement in such series if it elects to quote in such series and otherwise satisfies the requirements of Chapter VI, Section 10.

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