SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54238; File No. SR-NYSEArca-2006-13)

July 28, 2006

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Approving Proposed Rule Change and
Amendments No. 1 and 2 and Notice of Filing and Order Granting Accelerated Approval of
Amendment No. 3 Thereto Relating to the Establishment of the OX Trading Platform

I.   Introduction

On May 2, 2006, NYSE Arca, Inc. ("NYSE Arca" or "Exchange") filed with the

Securities and Exchange Commission ("Commission") a proposed rule change pursuant to

Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] to

establish the OX trading platform. The Exchange filed Amendments No. 1 and 2 to the proposed

rule change on June 9, 2006 and June 15, 2006, respectively. The proposed rule change was

published for comment in the Federal Register on June 23, 2006.[3] The Commission received one

comment on the proposal.[4] On July 27, 2006, the Exchange filed Amendment No. 3 to the

proposal.[5] This order approves the proposed rule change, as amended by Amendment Nos. 1 and

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

[3]   See Securities Exchange Act Release No. 53995 (June 15, 2006), 71 FR 36145 ("OX
         Notice").

[4]   See letter dated July 20, 2006 from Bryan Rule ("Rule Letter").

[5]   In Amendment No. 3, the Exchange: (i) made certain representations about entering into
         a agreement with the NASD pursuant to Rule 17d-2 under the Act following approval of
         this proposed rule change; (ii) offered further analysis of why the proposal is not
         inconsistent with Section 11(a) of the Act; (iii) clarified that Satisfaction Orders would be
         handled in the same manner as they are handled on PCX Plus; (iv) submitted a rule that
         would require a three second exposure period before certain orders could be crossed; (v)
         represented that NYSE Arca Rule 11.3 would require an OX Market Maker to maintain
         information barriers that are reasonably designed to prevent the misuse of material, non-
         public barriers between "side-by-side" market makers; (vi) removed a reference to an
         "Opening Only" order type; (vii) clarified the price at which certain orders would be
         executed in the Working Order Process and made other technical corrections to the
         proposal. The complete text of Amendment No. 3 is available on the Commission's Web

2, grants accelerated approval to Amendment No. 3, and solicits comments from interested persons on Amendment No. 3.

II.   Description of the Proposal

NYSE Arca proposes to establish rules for OX, a fully automated trading system for standardized equity options intended to replace NYSE Arca's current options trading platform, PCX Plus.[6] OX would provide an electronic order delivery, execution and reporting system for designated options listed and traded on NYSE Arca through which orders and quotes of Users[7] are consolidated for execution and display. Market Makers would be able to stream quotes to OX either from on the trading floor or remotely.

OX would be available for the entry and execution of quotes and orders to OTP Holders,[8] OTP Firms[9] and, through Sponsoring OTP Firms,[10] certain non-OTP Firms and Holders, known as Sponsored Participants[11] (collectively, "Users"). In general, Users would be able to enter market orders, marketable limit orders and limit orders. Only Market Makers would be permitted to enter quotes on OX. As Users enter bids and offers (i.e., orders and quotes) into the system, any non-marketable limit orders and quotes would be ranked in an electronic limit order file (the "OX Book")[12] according to price-time priority, such that within each price level, all bids and offers are organized by the time of entry. The OX Book (except for certain Working

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site (http://www.sec.gov/rules/sro.shtml), at the Commission's Public Reference Room, and at the Exchange.

[6]   See NYSE Arca Rule 6.90.

[7]   See proposed NYSE Arca Rule 6.1A(a)(19).

[8]   See NYSE Arca Rule 1.1(q).

[9]   See NYSE Arca Rule 1.1(r).

[10]   See proposed NYSE Arca Rule 6.1A(a)(17).

[11]   See proposed NYSE Arca Rule 6.1A(a)(16).

[12]   See proposed NYSE Arca Rule 6.1A(a)(14).

Orders[13] with conditional prices or sizes) would be displayed to all Users. For market orders or marketable limit orders, like-priced bids and offers would be matched by OX for execution at prices equal to or better than the NBBO pursuant to the following algorithm, which is based on price-time priority:

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

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

Step 3: If an order has not been executed in its entirety pursuant to Steps 1 and 2, the order would be routed to another Market Center[14] for execution (either through the intermarket options linkage ("Linkage") or via a broker-dealer affiliated with NYSE Arca, Archipelago Securities) unless the User has designated that the order may not be routed to another Market Center. If an order that is routed to another Market Center is not executed in its entirety, the order would be ranked and displayed in the OX Book in accordance with the terms of such order and such order would be eligible for execution.

The OX rules also would permit the crossing of orders on the trading floor via open outcry. Specifically, the Exchange would provide rules governing regular-way, facilitation, and solicitation crosses and introduce the ability for OTP Holders and OTP Firms to execute Mid-Point Crosses[15] in accordance with one of the three crossing rules.

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[13]   See proposed NYSE Arca Rule 6.62A(e).

[14]   See proposed NYSE Arca Rule 6.1A(a)(6).

[15]   See proposed NYSE Arca Rule 6.47(d).

OTP Holders and OTP Firms meeting certain qualifications would be permitted to register as either Lead Market Makers ("LMMs") or Market Makers in one or more option classes traded on OX.[16] In addition, LMMs would continue to be responsible for handling orders under the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan").[17]

III.   Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a national securities exchange[18] and, in particular, with the requirements of Section 6(b) of the Act.[19] Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 6(b)(5) of the Act[20] in that it is designed to facilitate transactions in securities; to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; to

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[16]   Unless specified, or unless the context requires otherwise, the term "Market Maker" as used herein refers to both Market Makers and LMMs.

[17]   See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). Subsequently, upon separate requests by the Philadelphia Stock Exchange, Inc. ("Phlx"), the Pacific Exchange, Inc. ("PCX"), and the Boston Stock Exchange, Inc., the Commission issued orders to permit these exchanges to participate in the Linkage Plan. See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70850 (November 28, 2000), 43574 (November 16, 2000), 65 FR 70851 (November 28, 2000) and 49198 (February 5, 2004), 69 FR 7029 (February 12, 2004).

[18]   In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[19]   15 U.S.C. 78f(b).

[20]   15 U.S.C. 78f(b)(5).

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.

    A.   <u>Access to OX</u>

As noted briefly above, the Exchange proposes to expand the types of market participants

eligible to trade on its options trading facility. OTP Holders and OTP Firms with access to PCX

Plus at the time of this proposal would continue to have access to the Exchange through the OX

platform. In addition, the Exchange proposes to permit entities that are neither OTP Holders nor

OTP Firms to access the OX platform as "Sponsored Participants." The Exchange proposes to

define a Sponsored Participant as a person, such as an institutional investor, who has entered into

a sponsorship agreement with a Sponsoring OTP Firm, that has been designated to execute,

clear, and settle transactions on the Exchange for the Sponsored Participant.

The Sponsored Participant and its Sponsoring OTP Firm would be required to enter into a

written agreement incorporating the provisions required by proposed NYSE Arca Rule 6.2(c).

Specifically, the Sponsoring OTP Firm would acknowledge, among other things, that all orders

entered by the Sponsored Participant and any executions occurring as a result of such orders are

binding in all respects on the Sponsoring OTP Firm and that it is responsible for any and all

actions taken by its Sponsored Participant. The Sponsoring OTP Firm also would be required to

provide the Exchange notice that it is responsible for the actions of its Sponsored Participant(s).

The Sponsored Participant, in turn, would agree, among other things, to comply with applicable

NYSE Arca rules and procedures as if it were an OTP Firm and agree to take precautions to

prevent unauthorized access to the Exchange. The Sponsored Participants would be required to

establish and maintain an up-to-date list of persons permitted to obtain access to OX on behalf of

the Sponsored Participant (i.e., "Authorized Traders")[21] and to provide that list to the Sponsoring

OTP Firm.

The Commission approved a substantially similar arrangement for trading on NYSE

Arca's predecessor entity, the Pacific Exchange, when the Commission approved the

establishment of the Archipelago Exchange ("ArcaEx")[22] as the equities trading facility of PCX

Equities, Inc.[23] The Commission believes that, like the arrangement that the Commission

previously approved for ArcaEx, the proposed sponsorship arrangement is consistent with the

Act.

B.   Display Order and Working Order Processes

Users of OX would be able to submit orders to an electronic file of orders in the OX

Book. The OX Book would feature two trading processes -- the "Display Order Process" and the

"Working Order Process." Bids and offers would be ranked, maintained, and executed generally

according to price-time priority.[24]

1.   Display and Rank of Orders in the Displayed and Working Order
        Processes

The Exchange would display all non-marketable Limit Orders in the Display Order

Process of the OX Book. Limit Orders, with no other conditions, and quotes would be ranked

based on the specified price and the time of original order or quote entry. The displayed portion

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[21]   See proposed NYSE Arca Rule 6.1A(a)(1).

[22]   NYSE Arca LLC is the successor entity to ArcaEx. See Securities Exchange Act Release
        No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006).

[23]   See Securities Exchange Act Release No. 44983 (October 25, 2001), 66 FR 55225
        (November 1, 2001) (SR-PCX-00-25).

[24]   Under certain circumstances, an LMM would be guaranteed participation, after all
        customer orders ranked ahead of the LMM have been executed, in an order when the
        LMM is quoting the NBBO, but lacks time priority among Users bidding or offering the
        same price. See proposed NYSE Arca Rule 6.76B.

of Reserve Orders[25] would be ranked in the Display Order Process at the specified limit price and the time of order entry. When the displayed portion of the Reserve Order is decremented completely, the displayed portion of the Reserve Order would be refreshed from the reserve amount for (1) the displayed amount or (2) the entire reserve amount, if the remaining reserve amount is smaller than the displayed amount. The refreshed quote would be submitted and ranked at the specified limit price and the new time that the displayed portion of the order was refreshed.

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

2.   Execution of Orders in the Display and Working Order Processes

Once a booked order becomes marketable or upon a User's entry of a marketable order, all orders in OX would be matched generally based upon price-time priority, as described more fully below. OX first would attempt to match incoming marketable bids and offers against bids or offers in the Display Order Process at the display price of the resident bids or offers for the total amount of option contracts available at that price or for the size of the incoming order, whichever is smaller. NYSE Arca proposes to allocate incoming marketable bids and offers as follows:

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[25]   See proposed NYSE Arca Rule 6.62A(e)(1).

If an LMM is quoting in the option series at the NBBO, an incoming marketable bid or offer would be matched against all Customer[26] orders at the NBBO ranked ahead of the LMM. The remaining balance of the incoming marketable bid or offer would be matched against the quote of the LMM for either: (1) an amount equal to 40% of the remaining balance of the incoming bid or offer up to the LMM's disseminated quote size or (2) the LMM's share in the order of ranking in the OX Book, whichever is greater. Any remaining balance of the incoming marketable bid or offer would be matched against remaining marketable orders and quotes in the Display Order Process in the order of their ranking. If the incoming marketable bid or offer has not been executed in its entirety, the remaining part of the order would be directed to the Working Order Process.

An incoming marketable bid or offer or portion thereof that fails to be executed in the Display Order Process, would be matched against orders within the Working Order Process in the order of their ranking.

3.   Routing Away

If an incoming marketable order has not been executed in its entirety on OX and has been designated as an order type that is eligible to be routed away, the order would be routed either in its entirety or as component orders for execution to other Market Center(s) disseminating the NBBO, either through the Linkage or through the use of the OX Routing Broker, as described below. Where an order or portion of an order is routed away and is not executed either in whole or in part at the other Market Center, the order would be ranked and displayed in the OX Book in accordance with the terms of the order, and the order would be eligible for execution. If an order

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[26]   See proposed NYSE Arca Rule 6.1A(a)(4).

has been designated as an order type that is not eligible to be routed away, the order either would

be placed in the OX Book or cancelled if the order would lock or cross the NBBO.

Further, the Working Order Process would provide a method for handling contingency

orders as well as other order types, such as Reserve Orders. The Commission believes that the

proposal is designed to avoid executions at prices inferior to the NBBO and is consistent with the

Linkage Plan, NYSE Arca Rule 6.94 (Order Protection), and the Act.

C.   New Order Types

The proposal would introduce several order types to NYSE Arca. In addition to the

Reserve Order, described above, among the most significant order types that NYSE Arca is

proposing to introduce are order types related to the routing away function. These new order

types are designed to provide greater flexibility to Users to better control the execution of their

orders.

1.   Inside Limit Order

An "Inside Limit Order" is defined as a limit order, which, if routed away, would be

routed to the market participant or participants with the best displayed price. Any unfilled

portion of the order would not be routed to the next best price level until all quotes at the current

best bid or offer are exhausted. If the order is no longer marketable, the order would be ranked

in the OX Book pursuant to the ranking and display provisions described above.

2.   NOW Order

A "NOW Order" is defined as a limit order that is to be executed in whole or in part on

OX, with any remainder routed away only to one or more "NOW Recipients" for immediate

execution. "NOW Recipients" would include any Market Center with which the Exchange

maintains an electronic linkage and that provides instantaneous responses to NOW Orders routed

from OX. Any portion of a NOW Order that is not immediately executed by the NOW Recipient would be cancelled. If a NOW Order is not marketable when it is submitted to OX, it would be cancelled.

   3. PNP Order

A "PNP (Post No Preference) Order" is defined as a limit order to buy or sell that is to be executed in whole or in part on the Exchange, and the portion not so executed would be ranked in the OX Book, without routing any portion of the order to another Market Center. The Exchange would cancel any PNP Order that would lock or cross the NBBO.

   D. Routing Broker and Linkage

   1. Routing Broker

As described above, in the event that an order is not marketable on OX, but is marketable on another exchange, the Exchange would route the order to another Market Center for execution. Orders could be routed either through Linkage or through a broker-dealer affiliate of NYSE Arca that acts as an agent for routing orders entered into OX by Users ("Routing Broker"),[27] based on preset parameters in its automated routing algorithm, subject to NYSE Arca rules. Accordingly, orders that would be eligible for routing over Linkage (e.g., public customer orders) could be routed to other Market Centers either as Principal Acting as Agent Orders ("P/A Orders")[28] via Linkage or as customer orders via Archipelago Securities, based on the automated routing algorithm parameters. Generally, non-customer orders and NOW Orders[29] would be routed to other Market Centers via Archipelago Securities. As described above, certain order

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[27] NYSE Arca proposes to use Archipelago Securities LLC ("Archipelago Securities"), a wholly-owned subsidiary of Archipelago Holdings Inc. and a registered broker-dealer, as the Routing Broker.

[28] See NYSE Arca Rule 6.92(a)(12)(i).

[29] See proposed NYSE Arca Rule 6.62A(i).

types, including Immediate or Cancel and PNP Orders, would not be eligible for routing away to other exchanges.

The OX order routing function of Archipelago Securities is an exchange "facility."[30] As such, any proposed rule change relating to Archipelago Securities' order-routing function must be filed with the Commission, and must operate in a manner that is consistent with the provisions of the Act applicable to exchanges with NYSE Arca rules. In Amendment No. 3, the Exchange proposes to clarify that the NASD, a self-regulatory organization ("SRO") unaffiliated with NYSE Arca or any of its affiliates, would continue to carry out oversight and enforcement responsibilities as the Designated Examining Authority designated by the Commission pursuant to Rule 17d-1 under the Act[31] with the responsibility for examining Archipelago Securities for compliance with the applicable financial responsibility rules.

Furthermore, in Amendment No. 3, the Exchange represents that it will enter into a new agreement with the NASD pursuant to Rule 17d-2 under the Act[32] (the "NYSE Arca Agreement") to expand the allocation to the NASD of regulatory responsibility to encompass all of the regulatory oversight and enforcement responsibilities with respect to Archipelago Securities, except for "real-time market surveillance." NYSE Arca will submit the NYSE Arca Agreement to the Commission under Rule 17d-2 within 90 days of the Commission's approval of this proposed rule change.

The Commission notes that this representation is substantially similar to a representation the Exchange made when it amended the certificate of incorporation of PCX Holdings, Inc., certain rules of the Pacific Exchange, and the bylaws of Archipelago Holdings, Inc

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[30]   See 15 U.S.C. 78c(a)(2).

[31]   17 CFR 240.17d-1.

[32]   17 CFR 240.17d-2.

("Archipelago") to facilitate the consummation of the merger between PCX Holdings, Inc. and

its subsidiaries, and Archipelago (the "Merger").[33] The Commission believes that delegating the

regulatory function for the oversight of its wholly-owned subsidiary should help to ensure

independence in the regulatory oversight of Archipelago Securities.

2.   Linkage Routing and Obligations

The OX system would facilitate the routing of P/A Orders to other Market Centers via

Linkage using the account of the LMM assigned to the option class being routed. The OX

system, however, would not automatically generate Principal Orders[34] on behalf of Market

Makers; rather, Eligible Market Makers[35] would be required to route their own Principal Orders

if they want their proprietary orders sent to other Market Centers via Linkage. Satisfaction

Orders[36] would be handled in the same manner on OX as they are handled on PCX Plus.[37]

The existing NYSE Arca rules that apply to Linkage obligations, NYSE Arca Rules 6.92

through 6.96, would apply to OTP Holders and OTP Firms accessing the OX system. For

example, those rules, in conjunction with the Linkage Plan, would continue to require: (1) OTP

Holders and OTP Firms to avoid Trade-throughs and to adjust their quotes in the event of a

locked or crossed market; and (2) for LMMs to handle inbound Linkage Orders. The

Commission believes that the Exchange's proposed automated routing of certain Linkage Orders

is consistent with the Linkage Plan.

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[33]   See Securities Exchange Act Release No. 52497 (September 22, 2005), 70 FR 56949 (September 29, 2005) (SR-PCX-2005-90).

[34]   See NYSE Arca Rule 6.92(a)(12)(ii).

[35]   In Amendment No. 3, NYSE Arca proposed a technical change to its Rule 6.92(a)(7)(ii) to include certain OX Market Makers within the definition of "Eligible Market Maker."

[36]   See NYSE Arca Rule 6.92(a)(12)(iii).

[37]   See Amendment No. 3, supra note 5.

E.   Market Makers

1.   Market Maker Obligations

The OX proposal provides for two types of market makers: LMMs and Market Makers. A Market Maker on OX would be an OTP Holder or OTP Firm registered with NYSE Arca for the purpose of submitting quotes electronically and effecting transactions as a dealer-specialist through the OX trading platform either from the trading floor or from off the trading floor. Market Makers would be designated as specialists on NYSE Arca for all purposes under the Act and rules and regulations thereunder. No more than one LMM would be appointed in each option class, and the Exchange would be required to appoint at least one LMM in each option class. The Exchange may appoint any number of Market Makers in each class, unless limited by quotation system capacity. However, the Exchange will not restrict access to any particular option class until the Commission approves objective standards for restricting such access.

A Market Maker would be required to, among other things, compete with other Market Makers to improve the market in all series of options classes to which the Market Maker is appointed, update market quotations in response to changed market conditions in all series of options classes within its appointed classes, honor its quotations, and submit quotations in accordance with maximum Exchange prescribed width requirements. In addition, LMMs and Market Makers would be required to provide continuous, two-sided quotes in their appointed issues for 99% and 60%, respectively, of the time the Exchange is open for trading in each issue. LMMs and Market Makers also would be required to trade at least 75% of their contract volume per quarter in classes within their appointment. Market Maker quotes would be "firm" for all orders that are routed to OX. The Exchange would evaluate Market Makers periodically to

determine whether they have fulfilled performance standards relating to, among other things, quality of markets, competition among Market Makers, and ethical standards.

In transitioning to the OX platform from PCX Plus, the Exchange proposes to eliminate provisions for the appointment of "Remote Market Makers" and "Supplemental Market Makers." Accordingly, the proposed rules for the OX platform do not direct where Market Makers must be physically located when effecting transactions on NYSE Arca and would eliminate "in-person" trading requirements applicable to Market Makers that trade on the floor.

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 a specialist or market maker on a national securities exchange.[38] The Commission believes that a Market Maker must have an affirmative 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. In this regard, the Commission believes that OX rules are reasonably designed to impose such affirmative obligations on OX Market Makers.

2.   Market Maker Authorized Traders

The Exchange is proposing to limit Market Maker access to OX to those OTP Holders or officers, partners, employees or associated persons of OTP Firms that are registered with the Exchange as Market Makers ("Market Maker Authorized Traders" or "MMATs"). MMAT candidates will be required to pass an examination to demonstrate knowledge of NYSE Arca rules prior to being approved by the Exchange as a Market Maker Authorized Trader. The proposal would also establish standards and procedures governing the suspension of registration

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[38]   See 12 CFR 221.5(c)(6).

of an MMAT. The Commission believes these requirements are reasonably designed to ensure that the Exchange is informed of the identities and qualifications of individuals accessing OX on behalf of Market Makers and are consistent with the Act.

3. Market Maker Risk Limitation

NYSE Arca is proposing to provide a mechanism for limiting Market Maker risk during periods of increased and significant trading activity. OX would activate the Market Maker Risk Limitation Mechanism in a Market Maker's appointed class whenever a designated number of executions (ranging between 5 and 100 executions) occurs within one second. Orders and quotes received by OX after the Mechanism is activated would not be executed against the Market Maker. The Commission believes that establishing a uniform one second standard in place of the existing variable "n" seconds standard on PCX Plus is consistent with the Act.

On the PCX Plus system, the Exchange disseminates a market on behalf of an LMM when there are no Market Makers quoting in a series and volume parameters are exceeded. The Exchange proposes that if the mechanism were activated under the OX system and there were no Market Makers quoting in a series, the Exchange would no longer generate two-sided quotes on behalf of the LMM. Instead, on OX, the best bids and offers residing in the OX Book would be disseminated as the BBO. If there were no orders in the OX Book in the issue at that time, OX would disseminate a bid of zero and an offer of zero. The Commission believes that the proposed approach is consistent with the Act.

4. Integrated Market Making

In Amendment No. 3, the Exchange represents that NYSE Arca Rule 11.3, which governs the use of material, non-public information, would apply to OTP Holders and OTP Firms trading on OX. The Exchange represents that this rule would require an OX Market

Maker to maintain information barriers -- reasonably designed to prevent the misuse of material,

non-public information by such member – between the OX Market Maker and any of its

affiliates that may act as specialist or market maker in any security underlying the options in

which the Market Maker makes a market on OX. The Commission believes that requiring

information barriers between the OX Market Maker and its affiliates with respect to transactions

in the option and the underlying security are important to reduce the opportunity for unfair

trading advantages or misuse of material, non-public information.[39]

        F.   Trading Auctions (Opening and Trading Halt)

The Exchange is proposing new procedures for initiating trading in a given options class

("Trading Auction"). The new procedures will apply to orders designated for inclusion in the

opening auction process ("Auction Process") and upon re-opening of trading after a trading halt.

In particular, the OX system will accept Market Orders and Limit Orders and quotes for

inclusion in the Trading Auction, up until the time the Trading Auction is initiated in that options

series. Non-Market Makers would be able to submit orders for inclusion in the Trading Auction,

and Market Makers would be able to submit two-sided quotes and orders. Contingency orders

would not participate in the Auction Process. Any eligible open orders residing in the OX Book

from the previous trading session would be included in the Auction Process.

After the primary market for the underlying security disseminates the opening trade or

the opening quote, the related option series would be opened automatically at a single price.

Among the most significant principles in the Trading Auction is that orders will have priority

over Market Maker quotes. In addition, orders in the OX Book that are not executed during the

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[39]   See Securities Exchange Act Release No. 47838 (May 13, 2003), 68 FR 27129, 27137 (May 19, 2003) (SR-PCX-2002-36).

Auction Process will be eligible for execution during the Core Trading Hours[40] immediately after

the conclusion of the Opening Auction.

The opening price of a series would be the price, as determined by the OX system, at

which the greatest number of contracts would trade at or nearest to the mid-point of the initial

NBBO calculated by the Exchange from the quotes disseminated by Options Price Reporting

Authority, if any, or the mid-point of the best quote bids and quote offers in the OX Book. Mid-

point pricing would not occur if that price would result in an order or part of an order being

traded through. Instead, the opening would occur at that limit price, or, if the limit price is

superior to the quoted market, within the range of 75% of the best quote bid and 125% of the

best quote offer. Orders and Marker Maker quotes that do not trade during the Trading Auction,

but are marketable against the initial NBBO following the Trading Auction, would "sweep"

through the OX Book and be executed in price/time priority. If the best price is at an away

Market Center, orders would be routed away to the appropriate Market Center, pursuant to

NYSE Arca rules.

The Commission believes that the proposed Trading Auction is reasonably designed to

facilitate executions at the opening and following trading halts. The Commission further

believes that the proposal is designed to avoid executions at prices inferior to the NBBO.

G.   Crossing Rules

Under the proposal, OTP Holders and OTP Firms would be permitted to conduct crossing

transactions on the floor of the Exchange. The Exchange is proposing to replace its existing

crossing rule with a new NYSE Arca Rule 6.47, which would govern crosses effected on the

trading floor. Consistent with the existing version of NYSE Arca Rule 6.47, the proposed

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[40]   See proposed NYSE Arca Rule 6.1A(a)(3).

amendment provides for non-facilitation (or "regular way") crosses, facilitation crosses, and

solicitation crosses. In all cases, orders must be announced to the trading crowd in open outcry,

and trading crowd participants would be given a reasonable time to respond with the prices and

sizes at which they would be willing to participate in the cross. With respect to all crosses, a

Trading Official would be available at each post on the trading floor to assist in the

determination of what is a "reasonable time," when necessary. Trading crowd participants who

make bids or offers equal to or better than the proposed cross price would be permitted to

participate in a cross.   In addition, in no event would a cross occur that would trade through the

NBBO or any bids or offers on the Book priced equal to or better than the proposed execution

price.

Floor Brokers holding orders to buy and sell the same option contract may cross such

orders after following the non-facilitation (regular way) cross procedures. After requesting bids

and offers in the option series from the trading crowd, the Floor Broker must bid above the

highest bid in the crowd, or offer below the lowest offer in the crowd, by at least the MPV. The

Floor Broker may then cross the orders at that price provided that the execution price is equal to

or better than the NBBO and that the Floor Broker satisfies any bids or offers on the Book that

are priced equal to or better than the proposed execution price.

With respect to facilitation crosses, which involve a Floor Broker holding a customer

order and an order for the account of an OTP Holder, OTP Firm, or entity under the common

control of a Market Maker representing the customer ("Facilitation Order"), the Floor Broker

must be willing to facilitate the entire size of the customer order in order to utilize the

mechanism, and the size of the customer order must be at least 50 contracts. After the Floor

Broker exposes the customer order to the trading crowd for a reasonable period of time, if at the

time of execution there is sufficient size to execute the entire customer order at an improved

price (or prices), the customer order would be executed at the improved price, so long as such

execution price is equal to or better than the NBBO.

If at the time of execution there is insufficient size to execute the entire customer order at

an improved price (or prices), a Floor Broker would be permitted to participate in up to 40% of

the balance of the order to be facilitated once bids or offers in the Book equal to or better than

the proposed execution price, non-member bids and offers in the trading crowd at or better than

the proposed execution price, and member bids and offers in the trading crowd priced better than

the proposed execution price, have been satisfied.[41] Thereafter, Market Makers in the trading

crowd who are bidding or offering the proposed execution price may participate in the balance of

the customer order based upon price-time priority.[42] The balance of the unexecuted agency

order, if any, would be executed against the remaining Floor Broker proprietary interest.

The proposal would also permit the crossing of solicited orders, which involve a Floor

Broker holding an order for a customer of an OTP Holder or OTP Firm for which the Floor

Broker solicits contra side interest in the trading crowd. Crosses involving Solicited Orders

would be handled in a manner whereby superior priced and equal priced orders in the book and

interest in the crowd which collectively is of sufficient size to execute against the original

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[41]   When executing the customer order to be facilitated against such bids and offers, bids and
offers representing customer orders would be required to be executed first. See proposed
NYSE Arca Rule 6.47(b)(7). The Commission notes that NYSE Arca's facilitation cross
procedures would allow all NYSE Arca members to avail themselves of the exception to
Section 11(a) of the Act set forth in Section 11(a)(1)(G) of the Act and Rule 11a-1(T).

[42]   The Floor Broker is responsible for determining the sequence in which Market Makers'
bids or offers are vocalized. See NYSE Arca Rule 6.75(f)(1). In the event that the bids
or offers of two or more Market Makers are made simultaneously, such bids or offers will
be deemed to be on parity and priority will be afforded to them, insofar as practicable, on
an equal basis. See NYSE Arca Rule 6.75(c).

customer order would be executed before the Solicited Order. Customer orders, at a given price, would be executed before non-Customer orders at the same price.[43]

The Exchange also proposes to add a new category of cross order, the Mid-Point Crossing Order. A Floor Broker who holds a Mid-Point Crossing Order to buy and sell an option contract at the mid-point between the electronically disseminated BBO or better in the subject option series would be permitted to cross such an order in accordance with the procedures for regular way, facilitation or solicitation crosses, as applicable.   The Mid-Point Cross will not occur if the price of the midpoint of the NYSE Arca BBO is inferior to the NBBO or if the mid-point does not fall on a standard increment.

In reviewing proposed crossing mechanisms, the Commission considers the potential that crosses will lock up large portions of order flow from intramarket price competition by granting certain market participants extensive participation guarantees, such as the guarantee granted to Floor Brokers in the proposed OX Facilitation cross. To that end, the Commission notes that the 40% participation guarantee that Floor Brokers would receive pursuant to the proposed Facilitation Procedure, as described above, is consistent with similar guarantees accorded to members effecting facilitation crosses on other exchanges.[44] The Commission believes that the proposed crossing procedures are reasonably designed to ensure that interest in the crowd and on the book is protected, in that all Customer interest at the same price (whether residing in the trading crowd or on the book) must be satisfied before other interest may be executed. The

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[43]   In Amendment No. 3, the Exchange clarified the Solicited Cross rule. Specifically, the Exchange represented that only orders that are represented by a Floor Broker as agent are eligible for crossing via the Solicited Order procedures. If the Floor Broker represents an order for a covered account, the member order must satisfy the requirements of Section 11(a) of the Act and the rules thereunder. The Commission further notes that the Exchange has represented that a member may not rely on the exception found in Section 11(a)(1)(G) of the Act when utilizing the solicited order procedures.

[44]   See, e.g., International Securities Exchange ("ISE") Rule 716(d).

Commission also believes that these procedures should promote intramarket price competition by providing market makers and other market participants with a reasonable opportunity to compete for the proposed cross.

The Commission further notes that the proposed OX rules would not permit electronic crosses. In Amendment No. 3, the Exchanges proposes to clarify that Users seeking to effect certain orders as agent against their own principal account must ensure that either the agency order or the User's quote must be displayed on OX for three second seconds prior to execution. Specifically the proposed rule would provide, among other things, that Users may not execute as principal orders they represent as agent unless agency orders are first exposed on the Exchange for at least three seconds or the User has been bidding or offering on the Exchange for at least three seconds prior to receiving an agency order that is executable against such bid or offer. The Commission believes this proposed order exposure provision is substantially similar to the rules of other SRO rules that require members to wait three seconds before executing principal orders against an order they represent as agent.[45] In addition, the Commission expects that the Exchange will closely surveil to ensure that all crossing transactions are not effected without first being exposed to intramarket competition.

H.   Section 11(a) of the Act

Section 11(a)(1) of the Act[46] prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises investment discretion (collectively, "covered accounts") unless an exception applies.

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[45]   See, e.g., ISE Rule 717.

[46]   15 U.S.C. 78k(a)(1).

Among the transactions excepted under Section 11(a)(1) are those by a dealer acting in the capacity of a market maker, bona fide arbitrage or hedge transactions, and transactions made to offset errors. In the proposed rule change, the Exchange has set forth its analysis of how the proposed rule change is consistent with Section 11(a) of the Act and the rules thereunder.

Rule 11a2-2(T) Interpretive Request

Rule 11a2-2(T) under the Act,[47] known as the "effect versus execute" rule, provides exchange members with another exception from the general Section 11(a)(1) prohibition. Rule 11a2-2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with Rule 11a2-2(T)'s conditions, a member (i) must transmit the order from off the exchange floor; (ii) must not participate in the execution of the transaction once it has been transmitted to the member performing the execution;[48] (iii) must not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in the connection with effecting the transaction except as provided in the rule. As described by the Commission, these four requirements – off-floor transmission, non-participation in order

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[47]   17 CFR 240.11a2-2(T).

[48]   The member may, however, participate in clearing and settling the transaction. The commenter raises concerns about whether the proposed OX system satisfies this prong of the "effect versus execute" rule. According to the commenter, the notice of the proposal states that "NYSE Arca 'may not participate in the execution of the transaction once the order has been transmitted'" and that "[t]he NYSE Arca plan does interfere with the transmission and execution of options orders." To support this assertion, the commenter states that orders may be routed away to different exchanges for execution in certain circumstances. See Rule Letter, supra note 4. The Commission believes that the commenter mischaracterizes the discussion of this prong of the "effect versus execute" rule set forth in the notice of the proposal. The OX Notice states that the exchange member and its associated person (not NYSE Arca, as stated by the commenter) may not participate in the execution of the transaction once the order has been transmitted. The Commission believes that OX satisfies this prong, as discussed above.

execution, execution through an unaffiliated member and non-retention of compensation for discretionary accounts – were "designed to put members and non-members on the same footing, to the extent practicable, in light of the purposes of Section 11(a)."[49] If a transaction meets the requirements of the "effect versus execute" rule, it will be deemed to be "consistent with the purpose of Section 11(a)(1) of the Act, the protection of investors, and the maintenance of fair and orderly markets."[50] The Exchange stated that given OX's automated matching and execution services, no Exchange member will enjoy any special control over the timing of execution or special order handling advantages for orders executed via OX, as all orders will be centrally processed for execution by computer, rather than being handled by a member through bids or offers made on the trading floor. The Exchange further stated that it believes that due to OX's open, electronic structure that is designed to prevent any Exchange members from gaining any time and place advantages, the Exchange believes that OX satisfies the four requirements of the "effect versus execute" rule as well as the general policy objectives of Section 11(a) of the Act.

1.   Off-Floor Transmission

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

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[49]   See Securities Exchange Act Release No. 14713 (April 27, 1978), 43 FR 18557, 18560 (May 1, 1978) ("1978 Release").

[50]   See Rule 11a2-2(T)(e) under the Act.

electronic means.[51] Like these other automated systems, the Exchange has represented that

orders sent to OX will be transmitted from remote terminals directly to the system by electronic

means and that most member orders, except as described below, will be submitted to OX from

off of the floor. Therefore, those members' orders sent to the OX system electronically from off

the Exchange floor satisfy the off-floor transmission requirement for the purposes of the "effect

versus execute" rule.

<div align="center">2.   Non-Participation in Order Execution</div>

The "effect versus execute" rule further provides that the exchange member and its

associated person may not participate in the execution of the transaction once the order has been

transmitted. The Exchange has represented that upon submission to OX, an order will enter the

queue and be executed against another order in the OX Book based on an established matching

algorithm. The execution depends not on whether an order is for the account of an Exchange

member, but rather, upon what other orders are entered into OX at or around the same time as the

subject order, what orders are resident in the OX Book and where the order is ranked based on

the price-time priority ranking algorithm. Therefore, the Exchange stated that at no time

following the submission of an order is an Exchange member able to acquire control or influence

over the result or timing of its order's execution. As a result, the Commission believes that the

non-participation requirement is met because OTP Holder or OTP Firm orders are matched and

executed automatically in OX.

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51   See letter from Larry E. Bergmann, Senior Associate Director, Division of Market
Regulation ("Division"), Commission, to Edith Hallahan, Associate General Counsel,
Phlx (March 24, 1999) ("VWAP Letter"); letter from Catherine McGuire, Chief Counsel,
Division, Commission, to David E. Rosedahl, PCX (November 30, 1998) ("OptiMark
Letter"); and letter from Brandon Becker, Director, Division, Commission, to George T.
Simon, Partner, Foley & Lardner (November 30, 1994) ("Chicago Match Letter").

3.   Execution through Unaffiliated Member

The third requirement of Rule 11a2-2(T) is that the exchange member who executes the

order be unaffiliated with the member initiating the order. The Commission has recognized,

however, that this requirement may be met where automated exchange facilities are used. For

example, in considering the operation of COMEX and PACE, among other systems, the

Commission noted that while there is no independent executing exchange member, the execution

of an order is automatic once it has been transmitted into the systems.[52] Because the design of

these systems ensures that members do not possess any special or unique trading advantages in

handling their orders after transmitting them to the exchange floors, the Commission has stated

or not objected to the Exchange's conclusion that executions obtained through these systems

satisfy the independent execution requirement of Rule 11a2-2(T) that the member not be

affiliated with the executing broker.[53] The Exchange stated that this requirement is satisfied by

the OX system because the design of OX ensures that members do not have any special or

unique trading advantages in handling their orders after transmission. Accordingly, a transaction

for a covered account that submitted directly by a member into OX, from off of the Exchange

floor, for execution satisfies the unaffiliated member requirement.

4.   Non-Retention of Compensation

Finally, Rule 11a2-2(T) requires that, in the case of a transaction effected for an account

with respect to which an exchange member or associated person thereof exercises investment

discretion, neither the member or its associated persons may retain compensation in connection

with effecting the transaction without the express written consent of the person authorized to

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[52]   See Securities Exchange Act Release No. 15533 (January 29, 1979), 44 FR 6084
(January 31, 1979) ("1979 Release"). See also VWAP Letter, OptiMark Letter and
Chicago Match Letter.

[53]   Id.

transact business for the account, given in accordance with the rule. Exchange members relying on Rule 11a2-2(T) for transactions effected through OX must comply with this condition of the rule. The Commission notes that NYSE Arca would enforce this requirement pursuant to its obligation under Section 6(b)(1) of the Act[54] to enforce compliance with the federal securities laws.

In Amendment No. 3, the Exchange clarified its discussion regarding the application of Rule 11a2-2(T) found in Amendment No. 1. Specifically, the discussion in Amendment 1 was limited to the application of Rule 11a2-2(T) to orders for covered accounts sent electronically to the OX system directly by the member from off of the exchange for execution. The Commission notes that the Exchange's discussion in Amendment No. 1 did not address instances where a member on the physical floor of the Exchange submits an order for a covered account into the OX system from the physical floor by electronic means. Accordingly, to rely on the exception set forth in Rule 11a2-2(T), the Exchange clarified that members must ensure that they send their orders from off the floor to an unaffiliated member for execution, in addition to meeting the rules' other requirements. If a member sends its order from off of the floor to an affiliated member that is on the floor who then directs the order into the OX system for execution, the member may not rely on Rule 11a2-2(T) for an exception from Section 11(a) of the Act. If a member wishes to rely on the exception found in paragraph (G) of Section 11(a)(1) of the Act, its order may only be executed on the physical floor of the Exchange. Member proprietary orders that rely on the exception found in Section 11(a)(1)(G) of the Act may not be entered into the OX system for execution.[55]

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[54]   15 U.S.C. 78f(b)(1).

[55]   The Exchange represented to the Commission's staff that it will submit to the Commission promptly a proposed rule change pursuant to Rule 19b-4 under the Act to

I. Accelerated Approval of Amendment No. 3

The Commission finds good cause for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after publishing notice of Amendment No. 3 in the Federal Register pursuant to Section 19(b)(2) of the Act.[56]

In Amendment No. 3, the Exchange represents that the NASD would continue to carry out oversight and enforcement responsibilities as the Designated Examining Authority designated by the Commission pursuant to Rule 17d-1 under the Act[57] with the responsibility for examining Archipelago Securities for compliance with the applicable financial responsibility rules. The Exchange also represented that it will enter into an agreement with the NASD pursuant to Rule 17d-2 under the Act[58] to provide that NYSE Arca will delegate to the NASD all regulatory oversight and enforcement responsibilities with respect to Archipelago Securities pursuant to applicable laws, except for real-time market surveillance, within 90 days of the Commission's approval of this proposed rule change. As discussed above, the Commission believes that these representations raise no new issues of regulatory concern.

As described in greater detail above, the Exchange also clarifies in Amendment No. 3 how the proposed OX trading platform and crossing procedures will comply with Section 11(a) of the Act and with the Linkage Plan. In the amendment, the Exchange also proposes to clarify its rules to incorporate an order exposure requirement comparable to similar rules adopted by the

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   prohibit the entry of member orders that must rely on the exception found in Section 11(a)(1)(G) of the Act into the OX system. Telephone conversation among Janet Angstedt, Acting General Counsel, NYSE Arca, Kelly Riley, Assistant Director, Commission, Hong-Anh Tran, Special Counsel, Commission, Raymond Lombardo, Special Counsel, Commission, and Tim Fox, Special Counsel, Commission on July 25, 2006.

[56] 15 U.S.C. 78s(b)(2).

[57] 17 CFR 240.17d-1.

[58] 17 CFR 240.17d-2.

other options exchanges. The Exchange represents in Amendment No. 3 that NYSE Arca Rule

11.3 would require an OX Market Maker to maintain information barriers, that are reasonably

designed to prevent the misuse of material, non-public information, with any affiliates that may

act as specialist or market maker in any security underlying the options for which the OTP

Holder/Firm acts as an OX Market Maker. In addition, the Exchange proposes to remove a

reference to an "opening only" order type that the Exchange did not specifically propose.

In Amendment No. 3, NYSE Arca also proposed to clarify that incoming marketable

orders would be matched against all Working Orders in the Working Order Process at the price

of the displayed portion (for Reserve Orders) or at the limit price (for all other Working Order

types).

The Commission notes that Amendment No. 3 is intended to reconcile apparent

inconsistencies in other parts of the Exchange's proposed rules. The Commission believes that

Amendment No. 3 raises no novel issues of regulatory concern, and is consistent with the Act.

Therefore, the Commission finds good cause exists to accelerate approval of Amendment No. 3,

pursuant to Section 19(b)(2) of the Act.[59]

IV.   Solicitation of Comment

Interested persons are invited to submit written data, views and arguments concerning

Amendment No. 3, including whether Amendment No. 3 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

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[59]   15 U.S.C. 78s(b)(2).

- Send an email to rules-comments@sec.gov. Please include File No. SR-NYSEArca-2006-13 on the subject line.

Paper Comments:

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

All submissions should refer to Amendment No. 3 to File No. SR-NYSEArca-2006-13. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NYSE Arca. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to Amendment No. 3 to File No. SR-NYSEArca-2006-13 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[60] that the proposed rule change (SR-NYSEArca-2006-13), as amended, be, and it hereby is, approved and Amendment No. 3 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[61]

Nancy M. Morris
Secretary

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[60]   15 U.S.C. 78s(b)(2).

[61]   17 CFR 200.30-3(a)(12).