

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57503; File No. SR-BSE-2008-10)

March 14, 2008

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Create a Delta Hedging Exemption from Equity Options Position Limits

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 27, 2008, the Boston Stock Exchange, Inc. (“BSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by BSE. The Exchange has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders it effective upon filing with the Commission. 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

BSE proposes to amend the rules of the Boston Options Exchange (“BOX”). The proposal would create a new exemption from equity options position and exercise limits for positions held by BOX Participants under the BOX Rules. The text of the proposed rule change is available at BSE, the Commission’s Public Reference Room, and www.bostonstock.com.

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

In its filing with the Commission, BSE included statements concerning the purpose of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

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. BSE 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 permit expanded hedge positions pursuant to a carefully crafted delta hedge exemption from equity options position limits in Section 7 of Chapter III of the BOX Rules.

All options traded on BOX are subject to position and exercise limits, as provided under Sections 7 and 9 of Chapter III of the BOX Rules. Position limits are imposed, generally, to maintain fair and orderly markets for options and other securities by limiting the amount of control one or more affiliated persons or entities may have over one particular options class or the security or securities that underlie that options class. BOX Rules also contain various hedge exemptions to allow certain hedged positions in excess of the applicable standard position limit.⁵

In recent years, options exchanges have increased the size of options position and exercise limits, as well as the size and scope of available hedge exemptions to the applicable position limits.⁶ These hedge exemptions generally require a one-to-one hedge, *i.e.*, one stock option contract must be hedged by the number of shares underlying the options contract, typically 100 shares. In practice, however, many firms do not hedge their options positions in

⁵ See Section 8 of Chapter III of the BOX Rules (Exemptions from Position Limits).

⁶ See, *e.g.*, Securities Exchange Act Release Nos. 55176 (January 25, 2007), 72 FR 4741 (February 1, 2007) (SR-CBOE-2007-08); 51244 (February 23, 2005), 70 FR 10010 (March 1, 2005) (SR-CBOE-2003-30); and 45603 (March 20, 2002), 67 FR 14751 (March 27, 2002) (SR-CBOE-00-12).

this manner. Instead, these firms engage in what is commonly known as “delta hedging.” Delta hedging varies the number of shares of the underlying security used to hedge an options position based upon the relative sensitivity of the value of the option contract to a change in the price of the underlying security.⁷

BOX proposes to adopt a new exemption from equity options position and exercise limits⁸ for positions held by BOX Participants and certain of their affiliates that are “delta neutral”⁹ under a “permitted pricing model” (as defined below), subject to certain conditions (“Exemption”). The proposed Exemption would only apply to equity stock options and options on exchange-traded funds (“ETFs”).

Any equity position that is not delta neutral would be subject to position and exercise limits, subject to the availability of other exemptions. Only the “option contract equivalent of

⁷ For example, a stock option contract with a delta of .5 will move \$0.50 for every \$1.00 move in the underlying stock.

⁸ The proposed rule change does not change the BOX Rules options exercise limits in Section 9 of Chapter III of the BOX Rules (Exercise Limits) because such exercise limits only apply to the extent that position limits under Section 7 of Chapter III of the BOX Rules are imposed. Thus, as delta neutral positions would be exempt from position limits under the proposed rule change, such positions also would be exempt from exercise limits. Similarly, for positions held that are not delta neutral, only the option contract equivalent of the net delta of such positions would be subject to exercise limits.

⁹ The term “delta neutral” would be defined as an equity option position that is hedged, in accordance with a permitted pricing model, by a position in the underlying security or one or more instruments relating to the underlying security, for the purpose of offsetting the risk that the value of the option position will change in response to incremental changes in the price of the security underlying the option position. See proposed Section 8 (b)(i) of Chapter III of the BOX Rules.

the net delta” of such position would be subject to the appropriate position limit.¹⁰

Only financial instruments relating to the security underlying an equity options position could be included in any determination of an equity options position’s net delta, or in determining whether the options position is delta neutral. In addition, BOX Participants could not use the same equity or other financial instrument position in connection with more than one hedge exemption. Therefore, a stock position used as part of a delta hedging strategy could not also serve as the basis for any other equity hedge exemption.

Permitted Pricing Model. Under the proposed rule, the calculation of the delta for any equity option position, and the determination of whether a particular equity option position is delta neutral, must be made using a permitted pricing model. A “permitted pricing model” is defined in proposed Section 8(b)(iii) of Chapter III, to mean the pricing model maintained and operated by the Options Clearing Corporation (“OCC”) and the pricing models used by: (i) a Participant or its affiliate subject to consolidated supervision by the Commission pursuant to Appendix E of Rule 15c3-1 under the Act; (ii) a financial holding company (“FHC”) or a company treated as an FHC under the Bank Holding Company Act of 1956, or its affiliate

¹⁰ Under the proposed rule, “option contract equivalent of the net delta” would mean the net delta divided by the number of shares underlying the option contract. “Net delta” would mean, at any time, the number of shares (either long or short) required to offset the risk that the value of an equity option position will change with incremental changes in the price of the security underlying the option position, as determined in accordance with a permitted pricing model. See proposed Section 8(b)(ii) of Chapter III of the BOX Rules.

subject to consolidated holding company group supervision;¹¹ (iii) a Commission-registered OTC derivatives dealer;¹² and (iv) a national bank.¹³

Aggregation of Accounts. Participants and non-Participant affiliates relying on the Exemption would be required to ensure that the permitted pricing model is applied to all positions in or relating to the security underlying the relevant options position that are owned or controlled by the Participant, or its affiliates.

However, the net delta of an options position held by an entity entitled to rely on the Exemption, or by a separate and distinct trading unit of such entity, could be calculated without

¹¹ The pricing model of an FHC or of an affiliate of an FHC would have to be consistent with: (i) the requirements of the Board of Governors of the Federal Reserve System (“FRB”), as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the FRB, provided that the Participant or affiliate of a Participant relying on this exemption in connection with the use of such model is an entity that is part of such company’s consolidated supervised holding company group; or (ii) the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company’s principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where “principal regulator” means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company – provided that the Participant or affiliate of a Participant relying on this exemption in connection with the use of such model is an entity that is part of such company’s consolidated supervised holding company group. See proposed Section 8(b)(iii)(3) of Chapter III of the BOX Rules.

¹² The pricing model of a Commission-registered OTC derivatives dealer would have to be consistent with the requirements of Appendix F to Rules 15c3-1 and 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder. Only an OTC derivatives dealer and no other affiliated entity (including a Participant) would be able to rely on this part of the Exemption. See proposed Section 8(b)(iii)(4) of Chapter III of the BOX Rules.

¹³ The pricing model of a national bank would have to be consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency. Only a national bank and no other affiliated entity (including a Participant) would be able to rely on this part of the Exemption. See proposed Section 8(b)(iii)(5) of Chapter III of the BOX Rules.

regard to positions in or relating to the security underlying the option position held by an affiliated entity or by another trading unit within the same entity, provided that: (i) the entity demonstrates to the satisfaction of Boston Options Exchange Regulation (“BOXR”), the regulatory subsidiary of BSE, that no control relationship, as defined in Section 7(e) of Chapter III of the BOX Rules, exists between such affiliates or trading units, and (ii) the entity has provided BOXR written notice in advance that it intends to be considered separate and distinct from any affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of the Exemption.¹⁴

Any Participant or non-Participant affiliate relying on the Exemption would be required to designate, by prior written notice to BOXR, each trading unit or entity whose options positions are required by BOX Rules to be aggregated with the options positions of such Participant or non-Participant affiliate relying on the Exemption for purposes of compliance with BOX position or exercise limits.¹⁵

Obligations of Participants and Affiliates. Any Participant relying on the Exemption would be required to provide a written certification to BOXR that it is using a permitted pricing model as defined in BOX Rules for purposes of the Exemption. In addition, by such reliance, such Participant would authorize any other person carrying for such Participant an account including, or with whom such Participant has entered into, a position in or relating to a security underlying the relevant option position to provide to BOXR or OCC such information regarding such account or position as BOXR or OCC may request as part of BOXR’s confirmation or verification of the accuracy of any net delta calculation under this Exemption.¹⁶

¹⁴ See proposed Section 8(b)(iv)(2) of Chapter III of the BOX Rules.

¹⁵ See proposed Section 8(b)(iv)(3) of Chapter III of the BOX Rules.

¹⁶ See proposed Section 8(b)(v)(1) of Chapter III of the BOX Rules.

The options positions of a non-Participant affiliate relying on the Exemption would have to be carried by a Participant with which it is affiliated.¹⁷ A Participant carrying an account that includes an equity option position for a non-Participant affiliate that intends to rely on the Exemption would be required to obtain from such non-Participant affiliate a written certification that it is using a permitted pricing model as defined in the BOX Rules for purposes of the Exemption.¹⁸

Reporting. Under proposed Section 8(b)(vi) of Chapter III of the BOX Rules, each Participant relying on the Exemption would be required to report, in accordance with Section 10 of Chapter III of the BOX Rules, (i) all equity option positions (including those that are delta neutral) that are reportable thereunder, and (ii) on its own behalf or on behalf of a designated aggregation unit pursuant to Section 8(c)(iv) of Chapter III, for each such account that holds an equity option position subject to the Exemption in excess of the levels specified in Section 7, the net delta and the options contract equivalent of the net delta of such position. The Exchange and other self-regulatory organizations are working on modifying the Large Options Position Report system and/or OCC reports to allow a Participant to indicate that an equity options position is delta neutral.

¹⁷ See proposed Section 8(b)(v)(2) of Chapter III of the BOX Rules.

¹⁸ In addition, the Participant would be required to obtain from such non-Participant affiliate a written statement confirming that such non-Participant affiliate: (a) is relying on the Exemption; (b) will use only a permitted pricing model for purposes of calculating the net delta of its option positions for purposes of the Exemption; (c) will promptly notify the Participant if it ceases to rely on the Exemption; (d) authorizes the Participant to provide to BOXR or the OCC such information regarding positions of the non-Participant affiliate as BOXR or OCC may request as part of BOXR's confirmation or verification of the accuracy of any net delta calculation under the Exemption; and (e) if the non-Participant affiliate is using the OCC model, has duly executed and delivered to BOXR such documents as Participant may require as a condition to reliance on the Exemption. See proposed Section 8(b)(v)(3) of Chapter III of the BOX Rules.

Records. Under proposed Section 8(b)(vii) of Chapter III of the BOX Rules, each Participant relying on the Exemption would be required to (i) retain, and would be required to undertake reasonable efforts to ensure that any non-Participant affiliate of the Participant relying on the exemption retains, a list of the options, securities and other instruments underlying each options position net delta calculation reported to the BOXR hereunder, and (ii) produce such information to BOXR upon request.

Reliance on Federal Oversight. As provided under proposed Section 8(b)(iii) of Chapter III of the BOX Rules, a permitted pricing model includes proprietary pricing models used by Participants and affiliates that have been approved by the Commission, the FRB or another federal financial regulator. In adopting the proposed Exemption, the Exchange would be relying upon the rigorous approval processes and ongoing oversight of a federal financial regulator. The Exchange notes that it would not be under any obligation to verify whether a Participant's or its affiliate's use of a proprietary pricing model is appropriate or yielding accurate results.

The Exchange will announce the operative date of the proposed rule change in a regulatory circular to be published no later than 30 days after the Commission issues a release regarding the proposal herein, or such later date as may be necessary to ensure completion of the required technology changes by the OCC and the Securities Industry Automation Corporation.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,¹⁹ in general, and furthers the objectives of Section 6(b)(5) of the Act,²⁰ in particular, in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free

¹⁹ 15 U.S.C. 78f(b).

²⁰ 15 U.S.C. 78f(b)(5).

and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange believes that the proposed delta neutral-based hedge exemption from equity options position and exercise limits is appropriate in that it is based on a widely accepted risk management method used in options trading. Also, the Commission has previously stated its support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.²¹

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

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

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

Because the foregoing rule change does not: (1) significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act²² and Rule 19b-4(f)(6) thereunder.²³

²¹ See Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59380 (November 3, 1998) (S7-30-97) (adopting rules relating to OTC Derivatives Dealers).

²² 15 U.S.C. 78s(b)(3)(A).

²³ 17 CFR 240.19b-4(f)(6).

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.²⁴ However, Rule 19b-4(f)(6)(iii)²⁵ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would allow the Exchange to implement the delta hedging exemption from equity options position limits without needless delay. The Commission notes that it recently approved a substantially similar proposal filed by the Chicago Board Options Exchange, Incorporated.²⁶ The Commission believes that BSE's proposal to create a delta hedging exemption from equity options position limits raises no new issues. For these reasons, the Commission designates the proposed rule change to be operative upon filing with the Commission.²⁷

At any time within 60 days of the filing of such proposed rule change the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.

²⁴ 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied the five-day pre-filing notice requirement.

²⁵ Id.

²⁶ See Securities Exchange Act Release No. 56970 (December 14, 2007), 72 FR 72428 (December 20, 2007) (SR-CBOE-2007-99).

²⁷ For the purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-BSE-2008-10 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, DC 20549-1090.

All submissions should refer to File Number SR-BSE-2008-10. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office

of BSE. 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-BSE-2008-10 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.²⁸

Florence E. Harmon
Deputy Secretary

²⁸ 17 CFR 200.30-3(a)(12).