SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69517; File No. SR- BOX-2013-22)

May 6, 2013

Self-Regulatory Organizations; BOX Options Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Rule 7170 (Obvious and Catastrophic Errors)

Pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 (the "Act")[2] and Rule 19b-4 thereunder,[3] notice is hereby given that, on April 26, 2013, BOX Options Exchange LLC (the "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

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

The Exchange proposes to amend Rule 7170 (Obvious and Catastrophic Errors). Specifically, the Exchange proposes to amend Rule 7170(h)(2) to permit the nullification of trades involving catastrophic errors in certain situations specified below. The text of the proposed rule change is available from the principal office of the Exchange, at the Commission's Public Reference Room and also on the Exchange's Internet website at http://boxexchange.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, the self-regulatory organization 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

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

2 15 U.S.C. 78a.

3 17 CFR 240.19b-4.

specified in Item IV below. The self-regulatory organization 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 proposal is to help market participants better manage their risk by addressing the situation where, under current rules, a trade can be adjusted to a price outside of a customer's limit. Specifically, the Exchange proposes to amend Rule 7170(h) to enable a Public Customer[4] who is the contra-side to a trade that is deemed to be a catastrophic error to have the trade nullified in instances where the adjusted price would violate the Public Customer's limit price. Only if the Public Customer, or his agent, affirms the Public Customer's willingness to accept the adjusted price through the Public Customer's limit price within 20 minutes of notification of the catastrophic error ruling would the trade be adjusted; otherwise it would be nullified. Today, all catastrophic error trades are adjusted, not nullified, on all of the options exchanges. This is a competitive filing that is based on a proposal recently submitted by NASDAQ OMX PHLX LLC ("PHLX") and approved by the Commission.[5]

Background

Currently, Rule 7170 governs obvious and catastrophic errors. Obvious errors are calculated under the rule by determining a theoretical price and determining, based on objective standards, whether the trade should be nullified or adjusted. The rule also contains a process for requesting an obvious error review. Certain more substantial errors may fall under the

4 Under BOX Rule 100(a)(51) the term "Public Customer" means a person that is not a broker or dealer in securities. This includes Professionals under BOX Rule 100(a)(50), but not broker-dealers or Market Makers.

5 See Securities Exchange Act Release No. 69304 (April 4, 2013), 78 FR 21482 (April 10, 2013) (Order Approving SR-Phlx-2013-005).

category of a catastrophic error, for which a longer time period is permitted to request a review and for which trades can only be adjusted (not nullified). Trades are adjusted pursuant to an adjustment table that, in effect, assesses an adjustment penalty. By adjusting trades above or below the theoretical price, the Rule assesses a ‘‘penalty’’ in that the adjustment price is not as favorable as the amount the party making the error would have received had it not made the error.

Proposal

At this time, the Exchange proposes to change the catastrophic error process to permit certain trades to be nullified. The definition and calculation of a catastrophic error would not change.[6] First whether a transaction is a catastrophic error is determined by the Exchange's MRC[7], if both parties to the trade are Public Customers then the trade would be adjusted under the current rule. However, if only one of the parties is a Public Customer, then the adjusted price would be compared to the limit price of the order. If the adjusted price would violate the limit price (in other words, be higher than the limit price if it is a buy and lower than the limit price if it is a sell order), then the Public Customer would be offered an opportunity to nullify the trade. If the Public Customer (or the Public Customer's broker-dealer agent) does not respond within 20 minutes, the trade would be adjusted under the current rule.

These changes should ensure that a Public Customer is not forced into a situation where the original limit price is violated and thereby the Public Customer is forced to spend additional dollars for a trade at a price the customer had no interest in trading and may not be able to afford.

6 Nor is the definition or process for obvious errors changing.

7 The MRC is the BOX Market Regulation Center.

EXAMPLE 1 – Resting Public Customer forced to adjust through his limit price and would prefer nullification

Day 1

8:00:00 am (pre-market) – Customer A enters order on BOX to buy 10 GOOG May 750 puts for $25 (cost of $25,000, Customer has $50,000 in his trading account).

10:00:00 am

GOOG trading at $750

May 750 puts $29.00-$31.00 (100x100) on all exchanges

10:04:00 am

GOOG drops to $690

May 750 puts $25-$100 (10x10)BOX May 750

puts $20-$125 (10x10) CBOE

May 750 puts $10-$200 (100x100) on all other exchanges

10:04:01 am

Customer B enters order to sell 10 May 750 puts for $25 (credit of $25,000)

10:04:01 am

10 May 750 puts execute at $25 ($35 under parity)[8] with Customer A buying and Customer B selling.

10:04:02 am (1 second later)

GOOG trading $690

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8 Parity is the intrinsic value of an option when it is in-the-money. With respect to puts, it is calculated by subtracting the price of the underlying from the strike price of the put. With respect to calls, it is calculated by subtracting the strike price from the price of the underlying.

May 750 puts $75-$78 (100x100) BOX May 750

puts $75-$80 (10x10) CBOE

May 750 puts $70-$80 (100x100) All other exchanges

No obvious error is filed within 20 minute notification time required by rule. If this had been an obvious error review, the trade would have been nullified in accordance with Rule 7170 because one of the parties to the trade was a non-market maker.

4:00:00 pm (the close)

GOOG trading $710

May 750 puts $60-$63 (100x100) BOX May 750

puts $55-$70 (10x10) CBOE

May 750 puts $50-$70 (100x100) All other exchanges

Day 2

- *8:00:00 am (pre-market)*

Customer B, submits S10 GOOG May 750 puts at $25 under Catastrophic Review. Trade meets the criteria of Catastrophic Error and is adjusted to $68 ($75 (the 10:04:02 am price less $7 adjustment penalty).

9:30:00 am (the opening)

GOOG trading $725

May 750 puts open $48.00-$51.00 (100x100) on all exchanges

Under current rule:

Without a choice, Customer A is forced to spend $68 (cost of $68,000, with only $25,000 in his account)

Puts are now trading $48, so Customer A shows a loss of $20,000 ($68 less $48x10 contracts x 100 multiplier)

Under proposed rule:

Customer A would be able to choose to have the B10 GOOG May 750 puts nullified avoiding both a loss, and an expenditure of capital exceeding the amount in his account.

Customer B would be relieved of the obligation to sell the puts at 25 because the trade would be nullified.

<u>EXAMPLE 2</u> – Resting Public Customer trades, sells out his position, thus would choose to keep the adjusted trade and avoid nullification

Day 1

8:00:00 am (pre-market) – Customer A enters order on BOX to Buy 10 BAC April 7.00 calls for $.01 (cost of $10 total. (Customer has $3,000 in his account).

10:00:00 am

BAC trading $11

April 7 calls $4.50-$4.70 (100x100) on all exchanges

10:04:00 am

BAC Trading $11

April 7 calls $.01-$4.70 (10x10) BOX April 7 calls

$4.50-$4.70 (10x10) CBOE

April 7 calls $4.50-$4.70 (10x10)) All other exchanges

10:04:01 am

Customer B enters order to sell 10 April 7 calls at $.01 on BOX with an ISO indicator (which allows trade through)

10:04:01 am

10 April 7 calls execute at $.01 on BOX Customer A buying and Customer B selling.

10:04:02 am (1 second later)

BAC is $11

April 7 calls $4.50-$4.70 (10x10) BOX April 7 calls

$4.50-$4.70 (10x10) CBOE

April 7 calls $4.50-$4.70 (10x10)) All other exchanges

No obvious error is filed within 20 minute notification time required by rule. If this had been an obvious error review, the trade would have been nullified.

11:00:00 am

BAC trading $9.60

April 7 calls $3.00-$3.25 (10x10) BOX April 7 calls

$.3.00-$3.25 (10x10) CBOE

April 7 calls $3.00-$3.25 (10x10)) All other exchanges

Customer A sells 10 April 7 calls at $3.00 (a total credit of $3,000 for a $2,990 profit)

3:00:00pm

BAC trading $12.80

April 7 calls $5.80-$6.00 (10x10) BOX April 7 calls

$5.80-$6.00 (10x10) CBOE

April 7 calls $5.80-$6.00 (10x10)) All other exchanges

Customer A has now no position and would be at risk of a loss if nullified.

3:20:00pm

Customer B submits S10 BAC April 7 calls at $.01 under Catastrophic Error Review. Trade meets the criteria of Catastrophic Error and is adjusted to $2.50 ($4.50 (the 10:04:02 am price) less $2 adjustment penalty).

Impact:

Under current Rule: Customer A would be adjusted to $2.50 ($4.50 (the 10:04:02 am price) less $2 adjustment penalty.

Under Proposed rule:

Illustrating the need for a choice, Customer A chooses within 20 minutes to accept an adjustment to $2.50 instead of a nullification, locking in a gain of $500 instead of $2.990 (B 10 at $2.50 vs. S10 at $3.00).

If not given a choice, Customer A would be naked short 10 calls at $3.00 that are now offered at $6.00 (a $3,000 loss).

These examples illustrate the need for the Public Customer to have a choice in order to manage his risk. By applying a notification time limit of 20 minutes, it lessens the likelihood that the Public Customer will try to let the direction of the market for that option dictate his decision for a long period of time, thus exposing the contra side to more risk. This 20 minute time period is akin to the notification period currently used in the rule respecting the notification period for starting the obvious error process for non-Market Maker Options Participants.[9]

For a market maker or a broker-dealer, the penalty that is part of the price adjustment process is usually enough to offset the additional dollars spent, and they can often trade out of the position with little risk and a potential profit. For a Public Customer who is not immersed in the day-to-day trading of the markets, this risk may be unacceptable. A Public Customer is

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[9] See BOX Rule 7170(g)(1).

also less likely to be watching trading activity in a particular option throughout the day and less likely to be closely focused on the execution reports the Public Customer receives after a trade is executed. Accordingly, the Exchange believes that it is fair and reasonable, and consistent with statutory standards, to change the procedure for catastrophic errors for Public Customers and not for other Participants.

The Exchange believes that the proposal is a fair way to address the issue of a Public Customer's limit price, yet still balance the competing interests of certainty that trades stand versus dealing with true errors. In 2009, the Exchange amended Rule 7170 to adopt the catastrophic error provision. In doing so, the Exchange stated that it had "weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made an Obvious Error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange stated that, while it believed that the Obvious Error Rule strikes the correct balance in most situations, in some extreme situations, Participants may not be aware of errors that result in very large losses within the time periods currently required under the rule. In this type of extreme situation, the Exchange believes Participants should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes Participants should only be given more time when the execution price is much further away from the theoretical price than is required for Obvious Errors so that relief is only provided in extreme circumstances."[10]

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[10] See Securities Exchange Act Release No. 59197 (January 5, 2009), 74 FR 969 (January 9, 2009)(SR-BSE-2008-52)(Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Catastrophic Errors).

The Exchange believes that this proposal is consistent with those principles because it strikes the aforementioned balance. The Exchange is proposing to amend Rule 7170 to eliminate the risk associated with Public Customers receiving an adjustment to a trade that is outside of the limit price of their order, when there is a catastrophic error ruling respecting their trade. The new provision would continue to entail specific and objective procedures. Furthermore, the new provision more fairly balances the potential windfall to one market participant against the potential reconsideration of a trading decision under the guise of an error.

The obvious and catastrophic error rules of the options exchanges are similar, especially with respect to only adjusting trades that result in a catastrophic error. Nevertheless, the Exchange believes, based on the aforementioned example, the recently approved Phlx filing, and Participant requests that this aspect of the catastrophic error process should change, as explained above. Relatedly, members of SIFMA's Options Committee also expressed concern during a recent meeting that this particular outcome may not be appropriate. Accordingly, the Exchange has determined to amend the rule.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act[11] in general, and furthers the objectives of Section 6(b)(5) of the Act[12] in particular, in that it is designed to promote just and equitable principles of trade, 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, by helping Participants better manage the risk

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11 15 U.S.C. 78f(b).

12 15 U.S.C. 78f(b)(5).

associated with potential erroneous trades. Specifically, the Exchange believes that the proposal is consistent with these principles because it provides a fair process for Public Customers to address catastrophic errors involving a limit order. In particular, the proposal still permits nullification in certain situations. Further, it gives Public Customers a choice. For two reasons, the Exchange does not believe that the proposal is unfairly discriminatory, even though it offers some Participants (Public Customers) a choice as to whether a trade is nullified or adjusted, while other Participants (Broker-Dealers and Market Makers) will continue to have all of their catastrophic errors adjusted. First, the rule currently differentiates among Participants: the notification period to begin the obvious error process is different for Market Makers and non-Market Maker Options Participants, and whether a trade is adjusted or busted also differs.[13] Second, options rules often treat Public Customers in a special way,[14] recognizing that Public Customers are not necessarily immersed in the day-to-day trading of the markets, less likely to be watching trading activity in a particular option throughout the day and may have limited funds in their trading accounts. Accordingly, differentiating among Participant types by permitting Public Customers to have a choice as to whether to nullify a trade involving a catastrophic error is not unfairly discriminatory, because it is reasonable and fair to provide Public Customers with additional options to protect themselves against the consequences of obvious errors.

The Exchange acknowledges that the proposal contains some uncertainty regarding whether a trade will be adjusted or nullified, depending on whether one of the parties is a Public

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13 See Rule 7170(g)(1).

14 For example, many options exchange priority rules treat Public Customers orders differently and some options exchanges only accept certain types of orders from Public Customers. Most options exchanges charge different fees for Public Customers.

Customer, because a person would not know, when entering into the trade, whether the other party is or is not a Public Customer. The Exchange believes that the proposal nevertheless promotes just and equitable principles of trade and protects investors and the public interest, because it eliminates a more serious uncertainty in the rule's operation today, which is *price* uncertainty. Today, a Public Customer's order can be adjusted to a significantly different price, as the examples above illustrate, which is more impactful than the possibility of nullification. Furthermore, there is uncertainty in the current obvious error portion of Rule 7170 (as well as the rules of other options exchanges), which Participants have dealt with for a number of years. Specifically, Rule 7170(g)(2) provides that if it is determined that an Obvious Error has occurred: (A) where each party to the transaction is either a market maker on the Exchange, the execution price of the transaction will be adjusted by the MRC, unless both parties agree to nullify the transaction within ten minutes of being notified by the MRC of the Obvious Error; or (B) where at least one party to the transaction in which an Obvious Error occurred is not a market maker on the Exchange, the MRC will nullify the transaction, unless both parties agree to adjust the price of the transaction within 30 minutes of being notified by the MRC of the Obvious Error. Therefore, a market maker who prefers adjustments over nullification cannot guarantee that outcome, because, if he trades with a Public Customer, a resulting obvious error would only be adjusted if the Public Customer agreed to an adjustment. This uncertainty has been embedded in the rule and accepted by market participants. The Exchange believes that this proposal, despite the uncertainty based on whether a Public Customer is involved in a trade, is nevertheless consistent with the Act, because the ability to nullify a Public Customer's trade involving a catastrophic error should prevent the price uncertainty that mandatory adjustment under the current rule creates, which should promote just and equitable principles of trade and protect investors and the public interest.

The proposal sets forth an objective process based on specific and objective criteria and subject to specific and objective procedures. In addition, the Exchange has again weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made a catastrophic error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. Accordingly, the Exchange has determined that introducing a nullification procedure for catastrophic errors is appropriate and consistent with the Act.

Consistent with Section 6(b)(8),[15] the Exchange also believes that the proposal does not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act, as described further below.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In this regard and as indicated above, the Exchange notes that the rule change is being proposed as a competitive response to the filing submitted by Phlx.[16] The Exchange believes this proposed rule change is necessary to permit fair competition among the options exchanges and to establish uniform rules regarding catastrophic errors. Currently, most options exchanges have similar, although not identical, rules regarding catastrophic errors. To the extent that this proposal would result in the Exchange's rule being different, market participants may choose to

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15 15 U.S.C. 78f(b)(5).

16 See supra, note 4.

route orders to the Exchange, helping the Exchange compete against other options exchanges for order flow based on its Public Customers service by having a process more responsive to current market needs. The proposal does not impose a burden on intra-market competition not necessary or appropriate in furtherance of the purposes of the Act, because, even though it treats different market participants differently, the Obvious and Catastrophic Errors rule has always been structured that way and adding the ability for Public Customers to choose whether a catastrophic error trade is nullified does not materially alter the risks faced by other market participants in managing the consequences of obvious errors. Overall, the proposal is intended to help market participants better manage the risk associated with potential erroneous options trades and does not impose a burden on competition.

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

The Exchange has neither solicited nor received comments on the proposed rule change.

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

This proposed rule change does not significantly affect the protection of investors or the public interest, does not impose any significant burden on competition, and, by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. The Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, prior to the date of filing the proposed rule change as required by Rule 19b-4(f)(6).[17] The proposed rule change is substantially similar in all material respects to a proposal submitted by Phlx that was recently

[17] 17 CFR 240.19b-4(f)(6).

approved by the Commission.[18] The Exchange believes that this proposed rule change, which is essential for competitive purposes and to promote a free and open market for the benefit of investors, does not raise any new, unique or substantive issues from those raised in the Phlx filing.

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- BOX-2013-22 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- BOX-2013-22. 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 website (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

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[18] See supra, note 4.

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 such 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 publicly available. All submissions should refer to File Number SR-BOX-2013-22 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.[19]

Kevin M. O'Neill
Deputy Secretary

[19] 17 CFR 200.30-3(a)(12).