

August 14, 2014

Self-Regulatory Organizations; BOX Options Exchange LLC; Order Granting Approval of a Proposed Rule Change to Adopt New Trade Allocation Algorithms for Matching Trades at the Conclusion of the PIP and the COPIP

I. Introduction

On June 16, 2014, BOX Options Exchange LLC (“Exchange” or “BOX”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules regarding the Price Improvement Period (“PIP”) and Complex Order Price Improvement Period (“COPIP”) (“auction mechanisms”). The proposed rule change was published for comment in the Federal Register on July 2, 2014.³ The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

The PIP⁴ and COPIP⁵ are electronic auction mechanisms that permit an Options Participant to expose an agency order (“PIP Order” for PIP and “COPIP Order” for COPIP, each, an “Agency Order”) and provide such order an opportunity for price improvement. Currently, the PIP and COPIP rules permit an initiating Options Participant (“Initiating Participant”) to submit an Agency Order into the PIP or COPIP along with a matching contra order (“Primary

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 72477 (June 26, 2014), 79 FR 37798 (“Notice”).

⁴ See BOX Rule 7150.

⁵ See BOX Rule 7245.

Improvement Order”). The Exchange will commence a PIP or COPIP by broadcasting a message to other Options Participants that contains information concerning series, size, auction start price, side of market, and time of conclusion. The PIP or the COPIP will last 100 milliseconds, unless terminated earlier due to certain circumstances. At the conclusion of the PIP or the COPIP, the Agency Order is matched against the best prevailing quotes or orders on BOX, including Improvement Orders⁶ and any Unrelated Orders,⁷ on a price/time priority basis, subject to certain exceptions.⁸

The PIP is utilized for the submission of agency orders for single options series instruments, while the COPIP is utilized for the submission of Complex Orders. BOX proposes to amend the PIP and the COPIP to amend the priority and allocation algorithms at the conclusion of the auction mechanisms. BOX further proposes to eliminate the broadcast of Improvement Order responses submitted during the PIP and the COPIP. In addition, BOX proposes to remove the Market Maker Prime⁹ designation and Customer PIP Order type (“CPO”) from the PIP.

A. Priority and Allocation at the Conclusion of the PIP

BOX proposes to amend the priority and trade allocation algorithm for matching orders at the conclusion of the PIP.¹⁰ The PIP Order will continue to be matched with opposite side

⁶ Improvement Orders are competing order submitted to the auction mechanisms by order flow providers and market makers. See Box Rule 7150(f)(1).

⁷ See BOX Rules 7150(a) (defining an Unrelated Order for purposes of the PIP auction as a non-Improvement Order entered into the BOX market during a PIP) and 7245(a) (defining an Unrelated Order for purposes of a COPIP auction as a non-Improvement Order entered on BOX during a COPIP or BOX Book Interest during a COPIP).

⁸ See BOX Rules 7150(f)(4) and 7245(f)(3).

⁹ See BOX Rule 7160.

¹⁰ See Notice, supra note 3, at 37799, for a detailed description of the current PIP allocation process.

competing orders and quotes in price priority. If the total quantity of orders, quotes, Improvement Orders, Legging Orders¹¹ and the Primary Improvement Order is equal to or less than the quantity of the PIP Order at a given price level, all orders at the price will be filled and the balance of the PIP Order will be executed at the next best price. If the total quantity of orders, quotes, Improvement Orders, Legging Orders, and the Primary Improvement Order is greater than the quantity of the PIP Order at a given price level, the allocation will be as described below.

Public Customer Allocation

BOX proposes that all orders, other than Legging Orders and the Primary Improvement Order, for the account of Public Customers,¹² whether Improvement Orders or Unrelated Orders, including quotes and orders on the BOX Book prior to the PIP Broadcast, will be allocated for execution against the PIP Order first.¹³ Where there are multiple such orders for the account of Public Customers at the same price, the trade allocation will be by time priority.¹⁴ BOX has represented that this allocation methodology is the same as the allocation for the price improvement auction on NASDAQ OMX PHLX (“Phlx”).¹⁵

Primary Improvement Order Allocation

After the Public Customer allocation, the Primary Improvement Order will receive its

¹¹ See BOX Rule 7240(c)(1).

¹² As discussed below under the heading “Professional Customers,” upon approval of the proposed rule change, Professionals would be treated in the same manner as broker-dealers for purposes of the PIP and COPIP, and not in the same manner as non-Professional Public Customers. See proposed BOX Rules 100(a)(50), 7150(a)(2) and 7245(a)(4).

¹³ See proposed BOX Rule 7150(g)(1).

¹⁴ See Notice, supra note 3, at 37800, for examples illustrating trade allocations where the Primary Improvement Order is for the account of a Public Customer.

¹⁵ See Notice, supra note 3, at 37800. See also Phlx Rule 1080(n)(ii)(E).

applicable trade allocation.¹⁶ Specifically, when a Single-Priced Primary Improvement Order¹⁷ is matched by or matches any competing Improvement Orders and/or non-Public Customers' Unrelated Orders at the final price level, the Initiating Participant's Primary Improvement Order retains priority for up to forty percent (40%) of the remaining size of the PIP Order after Public Customer orders are satisfied. However, if only one competing order matches the Initiating Participant's Single-Priced Primary Improvement Order at the final price level, then the Initiating Participant may retain priority for up to fifty percent (50%) of the remaining size of the PIP Order after Public Customer orders are satisfied.¹⁸

When an Initiating Participant submits a Max Improvement Primary Improvement Order,¹⁹ the Initiating Participant will be allocated its full size at each price level, except where restricted by the designated limit price, until a price level is reached where the balance of the PIP Order can be fully executed. At the final price level, the Initiating Participant will be entitled to receive up to forty percent (40%) of the remaining size of the PIP Order after Public Customer orders are satisfied. However, if only one competing order matches the Initiating Participant's Max Improvement Primary Improvement Order at the final price level, then the Initiating

¹⁶ See proposed BOX Rule 7150(g)(2). When starting a PIP, the Initiating Participant may submit to the Exchange the Primary Improvement Order with a designation of the total amount of the PIP Order it is willing to hat this is.to the other PIP Participants ("PIP Surrender Quantity"). If the Primary Improvement Order has designated a PIP Surrender Quantity, the Primary Improvement Order allocation will be reduced, if necessary, by the amount of the PIP Surrender Quantity. See Notice, supra note 3, at 37799-800.

¹⁷ See BOX Rule 7150(f) (defining the term as "a single price order that is equal to or better than that of the National Best Bid Offer ("NBBO") at the time of the commencement of the PIP.

¹⁸ See proposed BOX Rule 7150(h)(1). See Notice, supra note 3, at 37801, for an example illustrating allocation of 50% rather than 40% to the Primary Improvement Order.

¹⁹ See BOX Rule 7150(f) (defining the term as "an auto-match submission that will automatically match both the price and size of all competing quotes and orders at any price level achieved during the PIP or only up to a limit price").

Participant may retain priority for up to fifty percent (50%) of the remaining size of the PIP Order after Public Customer orders are satisfied.²⁰

Pursuant to proposed BOX Rule 7150(h), Public Customer orders and Legging Orders will not be considered when determining whether the Initiating Participant retains 40% or 50% because neither Public Customer order allocation nor Legging Order allocation will be affected by the Initiating Participant retaining the difference between 40% and 50%.

Market Maker Allocation

After the Primary Improvement Order allocation, any remaining unallocated quantity of the PIP Order will be allocated to orders and quotes, including Improvement Orders and quotes and orders on the BOX Book prior to the PIP Broadcast for the account of Market Makers.²¹

Where there are orders/quotes for the accounts of more than one Market Maker at the same price, the trade allocation formula for Market Makers will provide for the allocation of contracts among Market Makers based on size *pro rata* for the remaining contracts.

The proposed Market Maker allocation would follow the formula: $(B * C)$, where component B is derived by dividing the quantity of contracts for the Market Maker at the price level by the total quantity of contracts of all Market Makers at the price level, while component C is the remaining quantity of the PIP Order to be allocated after the Primary Improvement Order allocation. If the quantity of contracts for the Market Maker order in B is greater than the original quantity of the PIP Order, the Market Maker's quantity will be capped at the size of the original PIP Order for purposes of calculating B. If the trade allocation for a Market Maker would be greater than the quantity of the Market Maker order/quote at a price level, the Market

²⁰ See proposed BOX Rule 7150(h)(2). See Notice, *supra* note 3, at 37801, for an example illustrating allocation to the Primary Improvement Order with a specified auto-match limit price.

²¹ See proposed BOX Rule 7150(g)(3).

Maker's trade allocation will not exceed the size of the Market Maker order/quote at that price level. If the trade allocation for a Market Maker would result in a fraction of a contract, it will be rounded down. In certain circumstances, due to rounding down, it is possible that some Market Maker orders will not be filled even though there is sufficient quantity of the PIP Order to be allocated.²²

Remaining Orders Allocation

After the Market Maker allocation, any remaining unallocated quantity of the PIP Order will be allocated to any remaining orders, other than Legging Orders and Market Maker orders, including orders for the account of Professionals and orders on the BOX Book prior to the PIP Broadcast, not receiving allocation in the rounds described above.²³

Where there is more than one remaining unallocated order, including Improvement Orders, at the same price, the trade allocation to each such order will follow the formula: $(B * C)$ where component B is derived by dividing the quantity of contracts for the order at the price level by the total quantity of contracts for all remaining orders at the price level, while component C is the remaining quantity of the PIP Order to be allocated after the Market Maker allocation. If the quantity of contracts for the order in B is greater than the original quantity of the PIP Order, the quantity of contracts for the order will be capped at the size of the original PIP Order for purposes of calculating B. If the trade allocation for an order/quote would be greater

²² See Notice, supra note 3, at 37802, for an example illustrating Market Maker trade allocations.

²³ See proposed BOX Rule 7150(g)(4). Currently, Professionals are treated like Public Customers in circumstances where BOX yields priority to Public Customers under SEC Rule 11a1-1(T). Under the proposed rule change, pursuant to which Improvement Orders will not be broadcast, transactions executed on BOX will qualify under SEC Rule 11a2-2(T) as described below. As a result, Professionals will no longer be treated like Public Customers for purposes of priority. See Notice, supra note 3, at 37802, for an example showing a comparison of Professional Customer PIP trade allocation (before and after the proposed rule change).

than the quantity of the order/quote at the price level, the trade allocation will not exceed the size of the order/quote at the price level. If the trade allocation would result in a fraction of a contract, it will be rounded down.²⁴

Additional Allocation

If, at the end of the remaining orders allocation, there remains any unallocated quantity of the PIP Order, the balance will be allocated to all remaining quotes and orders, if any, other than Legging Orders and the Primary Improvement Order. The allocation method will be to allocate one contract of the PIP Order per quote/order sequentially until each remaining quote/order has received one contract or until the PIP Order is fully allocated. The allocation sequence among quotes/orders in this step will be in order of size with the largest remaining quote/order allocated first. Where two or more such quotes/orders are the same size, the trade allocation sequence will be by time priority.²⁵

Legging Order Allocation

If, after the allocation of all orders, quotes and Improvement Orders, there remains any unallocated quantity of the PIP Order, to the extent of any Surrender Quantity, allocation will be made to any Legging Orders at the same price in time priority.²⁶ If, at the end of the Legging Order allocation, there remains any unallocated quantity of the PIP Order, the balance will be

²⁴ See Notice, supra note 3, at 37802, for an example illustrating Market Maker trade allocations.

²⁵ See proposed BOX Rule 7150(g)(5). See Notice, supra note 3, at 37803, for an example illustrating additional allocation when limited by a PIP Surrender Quantity with multiple Market Maker orders.

²⁶ See proposed BOX Rule 7150(g)(6). Legging Orders may receive allocations of a PIP Order when the Legging Order is at a price better than the final price level or at the final price level in the event the Initiating Participant has specified a Surrender Quantity. See Notice, supra note 3, at 37803-4, for examples illustrating trade allocations where the Primary Improvement Order's PIP Surrender Quantity is: (i) greater than, and (ii) less than, the sum of Legging Orders at the final price level.

allocated to the Initiating Participant regardless of any applicable PIP Surrender Quantity.

Quotes and Orders on the BOX Book

Currently, all quotes and orders on the BOX Book prior to the PIP Broadcast, excluding any proprietary quotes or orders from the Initiating Participant, are filled at the end of the PIP in time priority before any other order at the same price.²⁷ In addition, current BOX Rule 7150(g)(3) states that the Primary Improvement Order follows in time priority all quotes and orders on the BOX Book prior to the PIP Broadcast that are equal to the: (A) Single-Priced Primary Improvement Order price; or (B) execution price of a Max Improvement Primary Improvement Order that results in the balance of the PIP Order being fully executed, except any proprietary quote or order from the Initiating Participant.

BOX proposes that quotes and orders on the BOX Book prior to the PIP Broadcast no longer be allocated against the PIP Order at the end of the PIP in time priority before any other order at the same price. Instead, as described above in the *Market Maker Allocation* Section above,²⁸ quotes and orders on the BOX Book prior to the PIP Broadcast will now be considered alongside all other quotes and orders, whether Improvement Order(s), Legging Order(s), or Unrelated Order(s) received by BOX during the PIP (excluding all Legging Orders and Unrelated Orders that were immediately executed during the interval of the PIP), for matching at the conclusion of the PIP. Consequently, BOX is proposing to remove the exceptions for quotes and orders on the BOX Book prior to the PIP Broadcast in BOX Rules 7150(f)(4)(i) and (g)(3). BOX has represented that this is consistent with Phlx.²⁹ Proprietary quotes or orders from the

²⁷ See BOX Rule 7150(f)(4)(i). See Notice, *supra* note 3, at 37804-5, for an example illustrating trade allocations for orders on the BOX Book prior to the PIP Broadcast, which are eligible for execution at the conclusion of the PIP.

²⁸ See Section II.A., *supra*.

²⁹ See Phlx Rule 1080(n)(ii)(E)(2).

Initiating Participant at the Primary Improvement Order price shall not be executed against the PIP Order during or at the conclusion of the PIP.

B. Priority and Allocation at the Conclusion of the COPIP

Pursuant to current BOX Rule 7245, Complex Orders may be submitted to the COPIP, which is substantially similar to the PIP except as necessary to account for distinctions between regular orders on the BOX Book and Complex Orders.³⁰ BOX proposes to amend the COPIP priority and allocation rule to adopt similar changes to those being proposed to the PIP allocation.³¹ Complex Orders on the Complex Order Book will continue to be executed in price/time priority, but in the event an execution opportunity occurs for a Complex Order on the Complex Order Book against a COPIP Order at the end of a COPIP, the COPIP execution will occur according to the priority algorithm described below.

Specifically, BOX has proposed that, at the end of the COPIP, the COPIP Order will continue to be matched with opposite side competing orders in price priority. If the total quantity of orders, Improvement Orders, BOX Book Interest and the Primary Improvement Order is equal to or less than the quantity of the COPIP Order at a given price level, all orders at the price will be filled and the balance of the COPIP Order will be executed at the next best price.

If the total quantity of orders, Improvement Orders, BOX Book Interest and the Primary Improvement Order is greater than the quantity of the COPIP Order at a given price level, the allocation will be as follows:

³⁰ References to Legging Orders do not appear in the COPIP rules because Legging Orders interact only with the PIP. However, the COPIP rules do include other provisions for interacting with interest on the BOX Book.

³¹ See Notice, supra note 3, at 37806-7, for a detailed description of the current COPIP allocation.

BOX Book Interest Allocation

BOX Book Interest is currently executed in priority over Complex Orders. BOX Book Interest³² will continue to be allocated for execution against the COPIP Order in priority over Complex Orders and in time priority.³³

Public Customer Allocation

After the BOX Book Interest allocation, Complex Orders, other than the Primary Improvement Order, for the account of Public Customers, including Improvement Orders and orders on the Complex Order Book prior to the COPIP Broadcast, will be allocated for execution against the COPIP Order in priority over other Complex Orders. Where there are multiple such Complex Orders for the account of Public Customers, allocation among all Public Customers, other than the Initiating Participant, at the same price will be by time priority.³⁴

Primary Improvement Order Allocation

After the Public Customer allocation, the Primary Improvement Order will receive its applicable trade allocation.³⁵ Specifically, when a Single-Priced Primary Improvement Order³⁶ is matched by or matches any Complex Order(s) at the final price level, the Initiating

³² “BOX Book Interest” is defined as bids and offers on the BOX Book for the individual legs of a Strategy. See BOX Rule 7245(a)(3).

³³ See proposed BOX Rule 7245(g)(1). See Notice, supra note 3, at 37807, for an example illustrating allocations of BOX Book Interest at multiple price levels eligible for execution at the end of a COPIP.

³⁴ See proposed BOX Rule 7245(g)(2). See Notice, supra note 3, at 37808, for examples illustrating allocations of Primary Improvement Orders for the accounts of Public Customers in two different scenarios.

³⁵ See proposed BOX Rule 7150(h). If the Primary Improvement Order has designated a COPIP Surrender Quantity, the Primary Improvement Order allocation will be reduced, if necessary, in accordance with the COPIP Surrender Quantity.

³⁶ See BOX Rule 7245(f) (defining the term as “a single price order that is equal to or better than cNBBO, cBBO (each as defined in [BOX] Rule 7240(a)) and BBO on the Complex Order Book for the Strategy at the time of the commencement of the COPIP.

Participant's Primary Improvement Order retains priority for up to forty percent (40%) of the remaining size of the COPIP Order after BOX Book Interest and Public Customer orders are satisfied. However, if only one Complex Order matches the Initiating Participant's Single-Priced Primary Improvement Order at the final price level, then the Initiating Participant may retain priority for up to fifty percent (50%) of the remaining size of the COPIP Order after BOX Book Interest and Public Customer orders are satisfied.³⁷

When the Initiating Participant submits a Max Improvement Primary Improvement Order,³⁸ the Initiating Participant shall be allocated its full size at each price level, except where restricted by the designated limit price, until a price level is reached where the balance of the COPIP Order can be fully executed. At the final price level, the Initiating Participant will be entitled to receive up to forty percent (40%) of the remaining size of the COPIP Order after BOX Book Interest and Public Customer orders are satisfied. However, if only one competing Complex Order matches the Initiating Participant's Max Improvement Primary Improvement Order at the final price level, then the Initiating Participant may retain priority for up to fifty percent (50%) of the remaining size of the COPIP Order after BOX Book Interest and Public Customer orders are satisfied.³⁹ Public Customer orders and BOX Book Interest will not be considered when determining whether the Initiating Participant retains 40% or 50% in proposed BOX Rule 7245(h) because neither Public Customer order allocation nor BOX Book Interest

³⁷ See proposed BOX Rule 7245(h)(1). See Notice, *supra* note 3, at 37809, for an example illustrating allocation of 50% rather than 40% to the Primary Improvement Order.

³⁸ See BOX Rule 7245(f) (defining the term as “an auto-match submission that will automatically match both the price and size of all competing orders, including Improvement Orders and Unrelated Orders, at any price level achieved during the COPIP or only up to a limit price”).

³⁹ See proposed BOX Rule 7245(h)(2). See Notice, *supra* note 3, at 37809-10, for examples illustrating COPIP allocation with and without auto-matching.

allocation will be affected by the Initiating Participant retaining the difference between 40% and 50%.⁴⁰

Market Maker Allocation

After the Primary Improvement Order allocation, any remaining unallocated quantity of the COPIP Order will be allocated to Complex Orders, including Improvement Orders and orders on the Complex Order Book prior to the COPIP Broadcast, for the account of Market Makers.⁴¹ Where there are Complex Orders for the accounts of more than one Market Maker at the same price, the trade allocation formula for Market Makers will provide for the allocation of contracts among Market Makers based on size pro rata for the remaining Strategies. The proposed Market Maker allocation would follow the formula: $(B * C)$ where component B is derived by dividing the quantity of Strategies for the Market Maker at the price level by the total quantity of Strategies for all Market Makers at the price level, while component C is the remaining quantity of the COPIP Order to be allocated after the Primary Improvement Order allocation. If the quantity of Strategies for the Market Maker order in B is greater than the original quantity of the COPIP Order, the Market Maker's quantity will be capped at the size of the original COPIP Order for purposes of calculating B. If the trade allocation for a Market Maker would be greater than the quantity of the Market Maker order at the price level, the Market Maker's trade allocation will not exceed the size of the Market Maker order at the price level. If the trade allocation for a Market Maker would result in a fraction of a Strategy, it will be rounded down. In certain circumstances, due to rounding down, it is possible that some Market Maker orders

⁴⁰ The first sentence of proposed BOX Rule 7245(h)(1) deletes from the current rule the words "or BOX Book Interest" in order to be consistent with the proposal not to consider BOX Book Interest for purposes of determining the Primary Improvement Order's trade allocation percentage.

⁴¹ See proposed BOX Rule 7245(g)(4).

will not be filled even though there is sufficient quantity of the COPIP Order to be allocated.⁴²

Remaining Complex Orders Allocation

After the Market Maker allocation, any remaining unallocated quantity of the COPIP Order will be allocated to any remaining Complex Orders, other than Market Maker orders, including orders for the account of Professionals and orders on the Complex Order Book prior to the COPIP Broadcast, not receiving allocation above.⁴³

Where there is more than one remaining unallocated Complex Order, including Improvement Orders, at the same price, the trade allocation to each such Complex Order will follow the formula: $(B * C)$ where component B is derived by dividing the quantity of Strategies for the Complex Order at the price level by the total quantity of Strategies for all remaining Complex Orders at the price level, while component C is the remaining quantity of the COPIP Order to be allocated after the Market Maker allocation. If the quantity of Strategies for the Complex Order in B is greater than the original quantity of the COPIP Order, the quantity of Strategies for the Complex Order will be capped at the size of the original COPIP Order for purposes of calculating B. If the trade allocation for a Complex Order would be greater than the quantity of Strategies for the Complex Order at the price level, the trade allocation will not exceed the quantity of Strategies for the Complex Order at the price level. If the trade allocation would result in a fraction of a Strategy, it will be rounded down.

Additional Allocation

The balance of the COPIP Order will be allocated to all remaining orders, if any, other

⁴² See Notice, *supra* note 3, at 37810, for an example illustrating COPIP allocations to Market Makers.

⁴³ See proposed BOX Rule 7245(g)(5). See Notice, *supra* note 3, at 37810-1, for an example illustrating comparison of COPIP trade allocations to Professionals before and after the proposed rule change.

than the Primary Improvement Order. The allocation method will be to allocate one Strategy of the COPIP Order per order sequentially until each remaining order has received one Strategy or until the COPIP Order is fully allocated. The allocation sequence among orders in this step will be in order of size with the largest remaining order allocated first. Where two or more such orders are the same size, trade allocation sequence will be by time priority. If, at the end of the additional allocation, there remains any unallocated quantity of the COPIP Order, the balance will be allocated to the Initiating Participant regardless of any applicable COPIP Surrender Quantity.⁴⁴

Complex Orders on the Complex Order Book

Currently, all Complex Orders on the Complex Order Book prior to the COPIP Broadcast, excluding any proprietary orders from the Initiating Participant, are filled at the end of the COPIP in time priority before any other Complex Orders at the same price.⁴⁵ Further, BOX Rule 7245(g)(3) states that the Primary Improvement Order follows in time priority all Complex Orders on the Complex Order Book prior to the COPIP Broadcast that are equal to the: (A) Single Priced Primary Improvement Order price; or (B) execution price of a Max Improvement Primary Improvement Order that results in the balance of the COPIP Order being fully executed, except any proprietary order(s) from the Initiating Participant.

BOX proposes that quotes and orders on the Complex Order Book prior to the COPIP Broadcast will no longer be allocated against the COPIP Order at the end of the COPIP in time priority before any other order at the same price. Specifically, quotes and orders on the Complex Order Book prior to the COPIP Broadcast will now be considered alongside all other orders,

⁴⁴ See proposed BOX Rule 7245(g)(6). See Notice, *supra* note 3, at 37811, for an example illustrating additional allocation to multiple market maker orders when limited by a COPIP Surrender Quantity.

⁴⁵ See BOX Rule 7245(f)(3)(ii).

whether Improvement Order(s), including Unrelated Order(s) received by BOX during the COPIP (excluding all Unrelated Orders that were immediately executed during the interval of the COPIP), for matching at the conclusion of the COPIP.⁴⁶ Therefore, BOX has proposed removing the exceptions for quotes and orders on the BOX Book prior to the COPIP Broadcast in BOX Rules 7245(f)(3)(ii) and (g)(3). BOX has represented that this proposed change is consistent with Phlx.⁴⁷ Proprietary quotes or orders from the Initiating Participant at the Primary Improvement Order price shall not be executed against the COPIP Order during or at the conclusion of the COPIP.

C. Professional Customer Priority in the PIP and COPIP

Pursuant to BOX Rule 100(a)(50), a “Professional” is a person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Under current BOX rules, Public Customers, including Professionals, benefit from certain order priority advantages in PIP and COPIP transactions on BOX (“Order Priority”). BOX proposes to amend Rule 100(a)(50), and related cross references in BOX Rules 7150(a)(2) and 7145(a)(4), to limit the availability of order priority advantages in PIP and COPIP transactions to non-Professional, Public Customers on BOX.⁴⁸ Thus Professionals will now be treated like non-Public Customers for order priority

⁴⁶ See Notice, *supra* note 3, at 37811-2, for an example illustrating allocation to orders on the Complex Order Book prior to the COPIP Broadcast for orders eligible for execution at the conclusion of the COPIP.

⁴⁷ See Phlx Rule 1080(n)(ii)(E)(2)(d).

⁴⁸ See proposed BOX Rule 7150(g)(4). Currently, Professionals are treated like Public Customers in circumstances where BOX yields priority to Public Customers under SEC Rule 11a1-1(T). Under the proposed rule change, pursuant to which Improvement Orders will not be broadcast, transactions executed on BOX will qualify under SEC Rule 11a2-2(T) as described below. As a result, Professionals will no longer be treated like Public Customers for purposes of priority.

in PIP and COPIP transactions instead of receiving the same order priority afforded to non-Professional, Public Customers. According to BOX, the order-sending behavior and trading activity of Professionals tend to be more similar to broker-dealers trading on a proprietary basis, and therefore it is not unfairly discriminatory to give Professional orders the same priority as broker-dealers for allocation purposes. BOX has represented that other exchanges also treat Professionals as non-Public Customers for Order Priority in auction transactions.⁴⁹

D. Improvement Orders in PIP and COPIP

Currently, Improvement Order responses submitted during the PIP and COPIP are broadcast via the High Speed Vendor Feed (“HSVF”) but are not disseminated through OPRA.⁵⁰ The Exchange proposes to no longer broadcast Improvement Orders received during the PIP or the COPIP. The Exchange believes that this proposed change will encourage greater participation in the PIP and the COPIP, which may lead to greater price improvement because a Participant will be encouraged to submit Improvement Orders at the best possible price at which the Participant is willing to participate.⁵¹

BOX does not currently allow Participants to cancel their Improvement Orders and only allows them to decrease the size of their Improvement Order by improving the price of that order.⁵² BOX proposes to allow Participants to cancel their Improvement Orders at any time up to the end of the PIP or COPIP. Additionally, because a Participant will be able to cancel its Improvement Order and submit a new modified Improvement Order, BOX proposes to not allow a Participant to decrease the size of its Improvement Order by improving the price of that order.

⁴⁹ See Phlx Rule 1000(b)(14).

⁵⁰ See BOX Rules 7150(f)(1) and 7245(f)(1).

⁵¹ See Notice, supra note 3, at 37814.

⁵² See BOX Rules 7150(f)(2) and 7245(f)(2).

BOX believes that by allowing a Participant to cancel its Improvement Order, the Participant will be more willing to enter aggressively priced responses. BOX has represented that these proposed changes are consistent with Phlx's Rules.⁵³

E. PIP Market Maker Prime Designation and CPO Order Type

Current BOX Rule 7160 provides that at the commencement of each PIP, a single Market Maker Prime may be designated for that PIP only. When the PIP was first adopted, BOX introduced the Market Maker Prime designation to encourage Market Makers to quote aggressively on the BOX Book and not wait for a PIP to begin.⁵⁴ BOX proposes to eliminate the Market Maker Prime designation because, according to BOX, Market Makers rarely use the Market Maker Prime functionality.⁵⁵

Current BOX Rule 7150(h) provides for a CPO order type. A CPO allows a Public Customer to submit an order on a single options series, through an order flow provider ("OFP"),⁵⁶ specifying one price for entry on the BOX Book (in the applicable minimum increment for that series) and a different price for interaction with a PIP (in one cent increments). The CPO was intended to provide access to the PIP on behalf of a Public Customer. However, according to BOX, because CPOs are rarely submitted, BOX proposes to eliminate the CPO order type.⁵⁷ Public Customers may continue to submit orders to the BOX Book and

⁵³ See NASDAQ OMX PHLX LLC ("Phlx") Rule 1080(n)(ii)(6) and (n)(ii)(9). See Notice, supra note 3, at 37814.

⁵⁴ See Securities Exchange Act Release No. 47186 (January 14, 2003), 78 FR 3062 (January 22, 2003) (Notice of Filing SR-BSE-2002-15).

⁵⁵ See Notice, supra note 3, at 37805.

⁵⁶ As defined in BOX Rule 100(a)(45), the term Order Flow Provider or "OFP" means those Options Participants representing as agent Customer Orders on BOX and those non-Market Maker Participants conducting proprietary trading.

⁵⁷ See Notice, supra note 3, at 37805.

Improvement Orders during the PIP.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.⁵⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁵⁹ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect customers, issuers, brokers and dealers.

Under the proposed rule change, at the conclusion of a PIP, Public Customer orders have first priority to trade against the Agency Order. After the execution of Public Customer orders, the Primary Improvement Order may be allocated up to 40% of the remaining size of the PIP Order (however, if only one competing order matches the Primary Improvement Order, then the Primary Improvement Order may be allocated up to 50% of the PIP Order). Market Maker orders and quotes next have priority. After the Market Maker allocation, any remaining unallocated quantity of the PIP Order will be allocated to any remaining orders (other than Legging Orders and Market Maker orders), including orders for the account of Professionals. Legging Orders have final priority. Under the proposed rule change, the allocation at the

⁵⁸ 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁵⁹ 15 U.S.C. 78f(b)(5).

conclusion of a COPIP auction is substantially the same as the allocation at the conclusion of a PIP auction except BOX Book Interest has priority over all orders at the end of a COPIP auction. The Commission believes that the proposed matching algorithm set forth in the PIP and the COPIP rules are sufficiently clear regarding how orders are to be allocated in the PIP and the COPIP auctions and do not raise any novel issues. The proposed changes to the PIP and COPIP mechanisms are similar in many aspects to the features found in the price improvement mechanisms of other options exchanges, including: the ability to cancel Improvement Orders;⁶⁰ the non-dissemination of Improvement Orders to OPRA;⁶¹ and the execution allocation scheme which gives Public Customers and the Initiating Participant priority over other Participants and Professional Customers,⁶² and the execution of orders on the book at the end of the PIP auction.⁶³

Under the proposed rule change, Improvement Orders will no longer be disseminated to Participants and to OPRA. The Commission notes that, according to the Exchange, this may encourage Participants to submit Improvement Orders at the best possible price that the Participant is willing to interact with the Agency Order, which could lead to greater price improvement for the Agency Order.⁶⁴

Finally, BOX will eliminate the Market Maker Prime designation and CPO order type. According to the Exchange, Market Makers rarely use the Market Maker Prime functionality. The Commission notes that Public Customers currently have and will continue to have

⁶⁰ See, e.g., Chicago Board Options Exchange, Incorporated (“CBOE”) Rule 6.74A(b)(1)(I).

⁶¹ See, e.g., CBOE Rule 6.74A(b)(1)(F), Phlx Rule 1080(n)(ii)(A)(6).

⁶² See, e.g., ISE Rule 723(d), Miami International Securities Exchange LLC (“MIAX”) Rule 515A(a)(2)(iii), and Phlx Rule 1080(n)(ii)(E).

⁶³ See *id.*

⁶⁴ See Notice, *supra* note 3, at 37814.

opportunities to participation in the PIP and COPIP, without the limitations that the CPO order type would impose.

IV. Section 11(a) of the Act

Section 11(a)(1) of the Act⁶⁵ 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 discretion (collectively, “covered accounts”) unless an exception applies. Rule 11a2-2(T) under the Act,⁶⁶ known as the “effect versus execute” rule, provides exchange members with an exemption from the 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 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) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution; (iii) may 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 connection with effecting the transaction except as provided in the Rule. For the reasons set forth below, the Commission believes that BOX’s Participants effecting transactions through the PIP and COPIP, including executions of PIP Orders and COPIP Orders against orders on the BOX Book and the Complex Order Book, would satisfy the requirements of Rule 11a2-2(T).⁶⁷

⁶⁵ 15 U.S.C. 78k(a)(1).

⁶⁶ 17 CFR 240.11a2-2(T).

⁶⁷ The Commission notes that it has previously found that transactions effected through the BOX PIP and COPIP are consistent with the requirements of Section 11(a), relying in part upon Rule 11a1-1(T) and in part upon Rule 11a2-2(T) thereunder. See Securities Exchange Act Release Nos. 68177 (November 7, 2012), 77 FR 67851 (November 14, 2012) and 71148 (December 19, 2013), 78 FR 78437 (December 26, 2013).

The Rule's first condition is that orders for covered accounts be transmitted from off the exchange floor. The Commission has previously found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange's floor by electronic means.⁶⁸ The Exchange has represented that orders sent to BOX, regardless of where it executes within the BOX system, including the Complex Order Book, the BOX Book, a PIP or a COPIP, will be transmitted from remote terminals directly to BOX by electronic means. The Exchange also represents that orders for covered accounts from OFPs and BOX Market Makers will only be submitted from electronic systems from remote locations, separate from BOX. Because the Exchange has represented that there are no other Options Participants that are able to submit order to BOX other than OFPs or Market Makers, the Commission believes that orders received through the PIP and COPIP would satisfy the off-floor transmission requirement.

Second, the Rule requires that the member not participate in the execution of its order. The Exchange represents that at no time following the submission of an order is a Participant able to acquire control or influence over the result or timing of an order's execution.⁶⁹

According to the Exchange, the execution of an order is determined by what other orders are entered into BOX at or around the same time, what orders are on the Complex Order Book and

⁶⁸ See, e.g., Securities Exchange Act Release Nos. 61419 (January 26, 2010), 75 FR 5157 (February 1, 2010) (SR-BATS-2009-031) (approving BATS options trading); 59154 (December 23, 2008), 73 FR 80468 (December 31, 2008) (SR-BSE-2008-48) (approving equity securities listing and trading on BSE); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080) (approving NOM options trading); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131) (approving The Nasdaq Stock Market LLC); 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (SR-PCX-00-25) (approving Archipelago Exchange); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (SR-NYSE-90-52 and SR-NYSE-90-53) (approving NYSE's Off-Hours Trading Facility); and 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) ("1979 Release").

⁶⁹ See Notice, *supra* note 3, 79 FR at 37816.

on the BOX Book, whether a PIP or COPIP is initiated and where the order is ranked based on the priority ranking algorithm.⁷⁰ In addition, as noted above, BOX proposes to no longer broadcast Improvement Orders received during the PIP and COPIP. As a result, responses to the PIP and COPIP auctions would no longer be visible to Participants.⁷¹ Accordingly, the Commission believes that a member does not participate in the execution of an order submitted through the PIP or the COPIP, including orders that execute against an order on the BOX Book or the Complex Order Book.

Third, Rule 11a2-2(T) requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that this requirement is satisfied when automated systems facilities are used, as long as 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.⁷² BOX has represented that the PIP and COPIP are designed so that no broker-dealer has any special or unique trading advantage in the handling of its orders after transmitting its orders to BOX.⁷³ Based on the Exchange's representation, the Commission believes that the PIP and COPIP satisfy this requirement.

⁷⁰ See id.

⁷¹ See Notice, supra note 3, 79 FR at 37814.

⁷² In considering the operation of automated execution systems operated by an exchange, the Commission noted that, while there is not an independent executing exchange member, the execution of an order is automatic once it has been transmitted into the system. 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, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T). See 1979 Release, supra note 55.

⁷³ See Notice, supra note 3, 79 FR at 37815.

Fourth, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2-2(T) thereunder.⁷⁴ BOX represents that Participants relying on Rule 11a2-2(T) for transactions effected through the PIP and COPIP must comply with this condition of the Rule and that the Exchange has represented that it will enforce this requirement pursuant to its obligation under Section 6(b)(1) of the Act to enforce compliance with federal securities laws.⁷⁵

⁷⁴ See 17 CFR 240.11a2-2(T)(a)(2)(iv). In addition, Rule 11a2-2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated persons thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth the total amount of compensation retained by the member in connection with effecting transactions for the account during the period covered by the statement. See 17 CFR 240.11a2-2(T)(d).

⁷⁵ See Notice, supra note 3, 79 FR at 37817.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁷⁶ that the proposed rule change (SR-BOX-2014-16), be and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁷⁷

Kevin M. O'Neill
Deputy Secretary

⁷⁶ 15 U.S.C. 78s(b)(2).

⁷⁷ 17 CFR 200.30-3(a)(12).