SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67592; File No. SR-BOX-2012-003)

August 3, 2012

Self-Regulatory Organizations; BOX Options Exchange LLC; Notice of Filing of Proposed Rule Change to Amend the Price Improvement Period

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 July 25, 2012, 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 7150 (The Price Improvement Period ("PIP")) to modify the execution of quotes and orders that are on the BOX Book prior to a PIP. The text of the proposed rule change is available at the principal office of the Exchange, on the Exchange's website at http://boxexchange.com, at the Commission's Public Reference Room, and on the Commission's website at http://www.sec.gov.

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 specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in

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

2 17 CFR 240.19b-4.

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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend the BOX Price Improvement Period ("PIP")[3] Rule 7150 to modify the execution of quotes and orders that are on the BOX Book prior to a PIP. Currently, Rule 7150(f) permits a PIP to begin at or better than the National Best Bid or Offer ("NBBO") and 7150(f)(1) provides that at the commencement of the PIP, all quotes and orders on the BOX Book prior to the PIP Broadcast that are equal to or better than (1) the Single-Priced Primary Improvement Order price or (2) the PIP Start Price of a Max Improvement Primary Improvement Order, except any proprietary quote or order from the Initiating Participant, will be immediately executed against the customer order designated for the PIP ("PIP Order") in price/time priority. The result of the current rule is that when an order is submitted to the PIP and there is sufficient quantity on the BOX Book prior to the PIP Broadcast to execute the PIP Order, the PIP never starts. For example: Submitted PIP Order to sell 100 contracts at NBBO of $2.00; Orders on the BOX Book prior to the PIP Broadcast:

- Public Customer to buy 30 contracts at $2.00;
- Market Maker A to buy 40 contracts at $2.00; and
- Broker-Dealer to buy 50 contracts at $2.00.

Under the current rule, the PIP Order executes 100 contracts against the orders on the Book at $2.00 in price/time priority as follows:

- Public Customer for 30 contracts;

[3] Capitalized terms not otherwise defined herein shall have the meaning as defined in the Exchange Rules.

- Market Maker A for 40 contracts; and
- Broker-Dealer for 30 contracts.

The PIP Order misses out on any potential opportunity for an execution at a better price, or prices, (price improvement) because the PIP never begins. The Exchange proposes to delete the provision in 7150(f)(1) noted above, amend 7150(f)(1), and 7150(f)(4), and add a new provision as 7150(g)(3). The proposed rule change to 7150(f)(1) would specify that at the conclusion of the PIP, the PIP Order shall be executed as set forth in 7150(f)(3), 7150(f)(4), 7150(g), and 7150(j).

Rule 7150(f)(4) sets out certain exceptions to time priority in the execution of the PIP Order. First, at the same price, if better than the PIP Start Price, Public Customer orders, whether an Improvement Order or an Unrelated Order, execute before non-market maker broker-dealer orders and all non-BOX Participant broker-dealer orders. Next, a proposed addition to 7150(f)(4)(i) would specify that all quotes and orders on the BOX Book prior to the PIP Broadcast, excluding any proprietary quote or order from the Initiating Participant, will be filled in time priority before any other order at the same price. Another technical, non-substantive change to 7150(f)(4)(i) inserts the defined term "Unrelated Order" in an instance where the undefined term "unrelated order" has been used.

Proposed new 7150(g)(3) states that the Primary Improvement Order follows in time priority in the PIP allocation to 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 notes that, similar to the current BOX Rules, such proprietary quote or order shall not be executed against the PIP Order during or at the conclusion of the PIP. As set forth above, among the quotes or orders on the BOX Book prior to the PIP Broadcast at the final execution price level, the PIP Order shall be matched against the quotes or orders in accordance with price/time priority as set forth in Rule 7130.

For example: Submitted PIP Order to sell 100 contracts with Single-Priced Primary Improvement Order to buy at NBBO of $2.00. Orders on the BOX Book prior to the PIP Broadcast:

- Public Customer to buy 30 contracts at $2.00;
- Market Maker A to buy 40 contracts at $2.00; and
- Broker-Dealer to buy 50 contracts at $2.00.

Improvement Orders submitted during PIP:

- Market Maker B to buy 40 contracts at $2.01, and
- Market Maker C to buy 30 contracts at $2.02.

Under the proposed rule change, the PIP Order would execute against the following:

- Market Maker C for 30 contracts at $2.02;
- Market Maker B for 40 contracts at $2.01; and
- Public Customer for 30 contracts at $2.00.

In this example, the PIP Order executes 70 contracts at a better price than it would under the current rule. BOX believes the proposed rule change will benefit Participants' customer orders by providing them an opportunity for price improvement they do not currently receive. Initiating Participants are required to guarantee an execution of the PIP Order at the NBBO or at a better price. The Initiating Participant's willingness to guarantee the customer order an execution at NBBO or a better price is important to the customer order gaining the opportunity for price improvement. Unfortunately, under the current BOX Rules, many PIP Orders do not have the opportunity to be exposed to competition in the PIP and potentially receive an execution at a better price. As such, BOX believes that the proposed rule change will benefit customers because it will ensure that more customer orders are exposed to that PIP competition and thus, more likely that such orders may receive price improvement. Orders on the BOX Book prior to the PIP, however, retain their priority over the Initiating Participant for allocation at the conclusion of the PIP at the same price. Such orders execute based on their time priority on the BOX Book prior to the PIP Broadcast. Options Participants' orders submitted to BOX are ranked and maintained in the BOX Book according to price/time priority, such that within each price level, all orders are organized by time of order entry. No distinction is made to this priority with regard to account designation (Public Customer, Broker/Dealer, or Market Maker). BOX believes that price/time priority provides an incentive for all market participants to post their best prices quickly.

The PIP has saved investors more than $388 million versus the prevailing NBBO since 2004, a monthly average of more than $3.8 million. BOX believes that the proposed rule change will result in additional PIP transactions, and thus, in customers having a greater opportunity to benefit from price improvement.

<u>Max Improvement Primary Improvement Orders</u>

Currently, if an Initiating Participant enters a Max Improvement Primary Improvement Order as defined in 7150(f), such an order automatically matches both the price and size of all competing quotes and orders at any price level achieved during the PIP, or up to a limit price as set by the Initiating Participant. At the conclusion of the PIP, a Max Improvement Primary Improvement Order will be allocated an equal number of contracts as the aggregate size of competing quotes and orders at each price level until a price level is reached where the balance of the PIP Order can be fully executed, except that the Initiating Participant will retain priority for 40% of the remaining PIP Order at the final price level. Otherwise, at the conclusion of the PIP, the PIP Order shall be matched against quotes and orders as set forth in 7150(f)(3) – (4), 7150(g), and 7150(j).

The Exchange proposes to amend 7150(g)(3) to provide that a Primary Improvement Order would yield priority to all quotes and orders on the BOX Book prior to the PIP Broadcast that are equal to or better than the 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. Similar to the current BOX Rules, such proprietary quote or order shall not be executed against the PIP Order during or at the conclusion of the PIP.

For example, a PIP Order is submitted to sell 100 contracts at NBBO of $2.00 with Max Improvement Primary Improvement Order to buy at prices up to $2.03, with a PIP Start Price of $2.00.

Orders on the BOX Book prior to the PIP Broadcast:

- Public Customer to buy 30 contracts at $2.00;
- Market Maker A to buy 40 contracts at $2.00; and
- Broker-Dealer to buy 50 contracts at $2.00.

Improvement Orders submitted during PIP:

- Market Maker B to buy 20 contracts at $2.01, and
- Market Maker C to buy 10 contracts at $2.02.

Under the proposed rule change, the PIP Order would execute against the following:

- Market Maker C for 10 contracts at $2.02;
- Initiating Participant for 10 contracts at $2.02;
- Market Maker B for 20 contracts at $2.01;
- Initiating Participant for 20 contracts at $2.01
- Public Customer for 30 contracts at $2.00; and
- Market Maker A for 10 contracts at $2.00.

In this example, the PIP Order executes 60 contracts at a better price than it would under the current rule. It is possible that the orders on the Book at NBBO prior to the PIP would not execute against the PIP Order that is submitted to the PIP at NBBO. The PIP Order, however, is still guaranteed an execution by the Initiating Participant, and receives price improvement better than the NBBO for a portion of the PIP Order. BOX notes, however, that the PIP Order could potentially receive improvement for the entire quantity of the order.

In the example above, the Initiating Participant is entitled to receive 10 contracts at $2.02 (matching the 10 contracts that are allocated $2.02), and 20 contracts at $2.01 (matching the 20 contracts allocated at $2.01). Because $2.00 is the final price level where the PIP Order is fully executed, the Public Customer is allocated 30 contracts and Market Maker A is allocated 10 contracts based on their price/time priority on the BOX Book prior to the PIP Broadcast. These orders on the BOX Book, however, retain their priority over the Initiating Participant at the final price level.

Rule 7150(g)(2) provides that when submitting a Max Improvement Primary Improvement Order, the Initiating Participant retains priority over other Improvement Orders for

40% of the remaining size of the PIP Order at the price where the PIP Order can be fully executed.

For example, a PIP Order is submitted to sell 100 contracts at NBBO of $2.00 with Max Improvement Primary Improvement Order to buy at prices up to $2.03, with a PIP Start Price of $2.00. Orders on the BOX Book prior to the PIP Broadcast:

- Public Customer to buy 10 contracts at $2.00;

Improvement Orders submitted during PIP:

- Market Maker B to buy 20 contracts at $2.01;
- Market Maker C to buy 10 contracts at $2.02;
- Broker-dealer to buy 25 contracts at $2.00.

Under the proposed rule change, the PIP Order would execute against the following:

- Market Maker C for 10 contracts at $2.02;
- Initiating Participant for 10 contracts at $2.02;
- Market Maker B for 20 contracts at $2.01;
- Initiating Participant for 20 contracts at $2.01
- Public Customer for 10 contracts at $2.00;
- Initiating Participant for 12 contracts at $2.00; and
- Broker-dealer for 18 contracts at $2.00

In this example, the PIP Order also executes 60 contracts at a price better than NBBO. The Initiating Participant is entitled to receive 10 contracts at $2.02 (matching the 10 contracts that are allocated $2.02), and 20 contracts at $2.01 (matching the 20 contracts allocated at $2.01). Because $2.00 is the final price level where the PIP Order is fully executed, the Public Customer on the BOX Book prior to the PIP Broadcast retains his priority over the Initiating Participant at the final price level and is allocated his 10 contracts. Finally, among the Improvement Orders at the final price of $2.00, the Initiating Participant retains priority for 40% of the remaining 30 contracts. Thus, the Initiating Participant is allocated 12 contracts at $2.00 and the Broker-dealer that submitted the Improvement Order is allocated the final 18 contracts at $2.00. As noted above, additional quantity on the BOX Book at the final execution price ($2.00 in this instance) prior to the PIP Broadcast, regardless of account type (e.g., Public Customer, Market Maker, or Broker-dealer), would retain priority over the Initiating Participant at that price and trade in price/time priority in the same fashion as they otherwise would on the BOX Book.

BOX notes that Unrelated Orders submitted to BOX will continue to execute with the PIP as they do within the current BOX Rules 7150(i) and 7150(j). The Exchange is not proposing any change to these Rules regarding Unrelated Orders. As stated in proposed Rule 7150(f)(4)(i), ". . .all quotes and orders on the BOX Book prior to the PIP Broadcast, excluding any proprietary quote or order from the Initiating Participant, will be filled in time priority before any other order at the same price." As such, Unrelated Orders received after a PIP Broadcast would execute in time priority after quotes and orders at the same price that were on the Book prior to the PIP Broadcast.

Upon Commission approval of the proposal, and at least one week prior to implementation of the proposed rule change, BOX will issue an Informational Circular to Participants, informing them of the implementation date. This will give Participants an opportunity to make any necessary modifications to coincide with the implementation date.

In connection with this proposed rule change, the Exchange will continue to provide to the Commission the following monthly data, and corresponding analysis, related to the PIP: (1) the number of orders of 50 contracts or greater entered into the PIP auction; (2) the percentage of all orders of 50 contracts or greater sent to BOX that are entered into the PIP auction; (3) the spread in the option at the time an order of 50 contracts or greater is submitted to the PIP auction; (4) the percentage of PIP trades executed at the NBBO plus $.01, plus $.02, plus $.03, etc.; and (5) the number of orders submitted by Order Flow Providers ("OFPs") and Market Makers when the spread was at a particular increment (e.g., $.05, $.10, $.15, etc.). Also, relative to item 5 above, for each spread, the Exchange will provide the percentage of contracts in orders of fewer than 50 contracts and for orders of 50 contracts or greater submitted to the PIP that were traded by: (a) the OFP or Market Maker that submitted the order to the PIP; (b) BOX Market Makers assigned to the class; (c) other BOX Participants; (d) Public Customer Orders (including Customer PIP Orders ("CPOs"));(e) Unrelated Orders (orders in standard increments entered during the PIP), and (f) quotes and orders on the BOX Book prior to the PIP Broadcast.

Further, BOX will provide, for the first and third Wednesday of each month, the: (a) total number of PIP auctions on that date; (b) number of PIP auctions where the order submitted to the PIP was fewer than 50 contracts; (c) number of PIP auctions where the order submitted to the PIP was 50 contracts or greater; (d) number of PIP auctions where the number of Participants (excluding the Initiating Participant) was zero, one, two, three, four, etc. Finally, the Exchange will continue to provide information each month with respect to situations in which the PIP is terminated prematurely or a Market Order, Limit Order, or BOX-Top Order immediately execute with a PIP Order before the PIP's conclusion. The following information will be provided: (1) the number of times that a Market Order, Limit Order, or BOX-Top Order in the same series on the same side of the market as the PIP Order prematurely terminated the PIP, and (a) the number of times such orders were entered by the same (or affiliated) firm that initiated the PIP that was terminated, and (b) the number of times such orders were entered by a firm (or an affiliate of such firm) that participated in the execution of the PIP Order; (2) for the orders addressed in each of 1(a) and 1(b) above, the percentage of PIP premature terminations due to the receipt, during the PIP, of a Market Order, Limit Order, or BOX-Top Order in the same series on the same side of the market as the PIP Order; and the average amount of price improvement provided to the PIP Order where the PIP is prematurely terminated; (3) the number of times that a Market Order, Limit Order, or BOX-Top Order in the same series on the opposite side of the market as the PIP Order immediately executed against the PIP Order, and (a) the number of times such orders were entered by the same (or affiliated) firm that initiated the PIP, and (b) the number of times such orders were entered by a firm (or an affiliate of such firm) that participated in the execution of the PIP Order; (4) for the orders addressed in each of 3(a) and 3(b) above, the percentage of PIP early executions due to the receipt, during the PIP, of a Market Order, Limit Order, or BOX-Top Order in the same series on the opposite side of the market as the PIP Order; and the average amount of price improvement provided to the PIP Order where the PIP Order is immediately executed; and (5) the average amount of price improvement provided to the PIP Order when the PIP runs for 100 milliseconds.

2. Statutory Basis

The Exchange believes that the proposal is consistent with the requirements of Section 6(b) of the Act,[4] in general, and Section 6(b)(5) of the Act,[5] in particular, that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. In particular, the Exchange believes this proposed rule change is a reasonable modification

4 15 U.S.C. 78f(b).

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

designed to provide additional opportunities for BOX Options Participants to obtain executions with price improvement for their customers while continuing to provide meaningful competition within the PIP. The Exchange also believes that the proposed rule change will increase the number of PIP transactions and participation in the PIP, which will ultimately enhance competition in the PIP and provide customers with additional opportunities for price improvement. The Exchange believes these changes are consistent with the goals to remove impediments to and to perfect the mechanism for a free and open market and a national market system.

Section 11(a) of the Act prohibits a member of a national securities exchange from effecting transactions on that exchange for his own account, the account of an associated person, or an account over which he or his associated person exercises investment discretion (collectively, "covered accounts"), unless an exception applies. The purpose of Section 11(a) is to address trading advantages enjoyed by the exchange members and conflicts of interest in money management.[6] In particular, as the Commission has stated, Congress enacted Section 11(a) out of concern about members benefiting in their principal transactions from special "time and place" advantages associated with floor trading – such as the ability to "execute decisions faster than public investors."[7] Section 11(a) includes several exceptions from the general prohibition for principal transactions that contribute to the fairness and orderliness of exchange transactions or do not reflect any time and place advantages. For example, Section 11(a)(1)

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6 See Securities Reform Act of 1975, Report of the House Comm. On Interstate and Foreign Commerce, H.R. Rep. No. 94-123, 94th Cong., 1st Sess. (1975); Securities Acts Amendments of 1975, Report of the Senate Comm. On Banking, Housing, and Urban Affairs, S. Rep. No. 94-75, 94th Cong., 1st Sess. (1975).

7 See Securities Exchange Act Release Nos. 14563 (March 14, 1978), 43 FR 11542, 11543 (March 17, 1978); 14713 (April 27, 1978), 43 FR 18557 ("April 1978 Release"); 15533 (January 29, 1979), 44 FR 6084 ("1979 Release").

provides that the prohibition on principal transactions does not apply to transactions by a dealer acting in the capacity of a market maker,[8] bona fide arbitrage, risk arbitrage or hedge transactions,[9] transactions by an odd lot dealer,[10] and transactions made to offset errors.[11]

The Commission has stated that it believes that transactions effected through the BOX PIP are consistent with the requirements in Section 11(a) of the Act and Rule 11a1-1(T) thereunder because Options Participants that are not market makers are required to yield priority in the PIP to all non-member orders, (i.e., to all Public Customer Orders and non-BOX Participant broker-dealer orders) at the same price.[12] Note that Participants, however, in addition to yielding priority to non-member orders at the same price, must also meet the other requirements under Section 11(a)(1)(G) of the Act and Rule 11a1–1(T) thereunder (or satisfy the requirements of another exception) to effect transactions for their own accounts.

As discussed below, the Exchange believes the PIP is generally consistent with Section 11(a)(1)(G) and Rule 11a1-1(T) under the Act because non-Market Maker Participant orders must yield to Public Customer orders.[13] The Exchange also believes, however, that the proposed

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8 Section 11(a)(1)(A).

9 Section 11(a)(1)(D).

10 Section 11(a)(1)(B).

11 Section 11(a)(1)(F).

12 See Securities Exchange Act Release No. 66871 (April 27, 2012), 77 FR 26323, at 26336 (May 3, 2012), In the Matter of the Application of BOX Options Exchange LLC for Registration as a National Securities Exchange Findings, Opinion, and Order of the Commission. See also Securities Exchange Act Release No. 49068 (January 13, 2004), 69 FR 2775, at 2790 (January 20, 2004) (establishing, among other things, the Boston Options Exchange, LLC options trading facility of BSE).

13 15 U.S.C. 78k(a)(1)(G) and 17 CFR. 240.11a1-1(T).

change to execute quotes and orders on the BOX Book prior to the PIP Broadcast against a PIP Order will satisfy the conditions of Rule 11a2-2(T) under the Act (the "Rule").[14]

Yielding to Public Customer Orders

Exchange Rules prohibit any orders for the accounts of non-Market Maker Options Participants to be executed prior to the execution of Public Customer Orders, whether an Improvement Order, including a CPO, or Unrelated Order, and non-BOX-Participant broker-dealer orders at the same price.[15] Section 11(a)(1)(G) and Rule 11a1-1(T) under the Act provide an exception to the general prohibition in Section 11(a) on an exchange member effecting transactions for its own account. Specifically, a member that "is primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, and acting as broker, or any one or more of such activities, and whose gross income normally is derived principally from such business and related activities"[16] and effects a transaction in compliance with the requirements in Rule 11a1-1(T)(a)[17] may effect a transaction for its own account. Among other things, Rule 11a1-1(T)(a) requires that an exchange member presenting a bid or offer for its own account or the account of another member shall grant priority to any bid or offer at the same price for the account of a non-member of the exchange. Because BOX Rules require Options Participants that are not Market Makers to yield priority in

14 17 CFR 240.11a2-2(T).

15 See Rule 7150(f)(4) and 7150(g)(3).

16 15 U.S.C. 78k(a)(1)(G)(i). Paragraph (b) of Rule 11a1-1(T) under the Act provides that a member shall be deemed to meet the requirements of Section 11(a)(1)(G)(i) of the Act if during its preceding fiscal year more than 50% of its gross revenues was derived from one or more of the sources specified in that section. In addition to any revenue which independently meets the requirements of Section 11(a)(1)(G)(i), revenue derived from any transaction specified in paragraph (A), (B), or (D) of Section 11(a)(1) of the Act or specified in Rule 11a1-4(T) shall be deemed to be revenue derived from one or more of the sources specified in Section 11(a)(1)(G)(i).

17 15 U.S.C. 78k(a)(1)(G)(ii).

the PIP to all non-member orders, BOX believes that the execution of PIP transactions on BOX is consistent with the requirements in Section 11(a) and Rule 11a1-1(T) under the Act.[18] The Exchange notes that BOX Options Participants, in addition to yielding priority to non-member orders at the same price, must also meet the other requirements under Section 11(a)(1)(G) and Rule 11a1-1(T) (or satisfy the requirements of another exception) to effect transactions for their own accounts.

Consistent with Section 11(a) of the Act, current BOX PIP Rules "prohibit any orders for the accounts of non-Market Maker BOX Options Participants to be executed prior to the execution of Public Customer Orders, both Public Customer PIP Orders and unrelated Customer Orders, and non-BOX Options Participant broker-dealer orders at the same price."[19] Although the Proposal would change when BOX "sweeps" the BOX Book in relation to the PIP, it would not change that Public Customers retain priority over certain other orders at the same price when executed at the end of a PIP transaction, except for quotes and orders on the BOX Book prior to the PIP Broadcast.

<u>Application of "Effect versus Execute" Exemption from Section 11(a) of the Act</u>

The Commission has stated that it believes that BOX Option Participants entering orders into the BOX Trading Host, excluding those transactions effected through the PIP process, will satisfy the conditions of Rule 11a2-2(T) ("the Rule").[20] The Exchange believes that the

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18 <u>Supra</u> n.12.

19 <u>See</u> Securities Exchange Act Release No. 66871 (April 27, 2012), 77 FR 26323, at 26336 (May 3, 2012), In the Matter of the Application of BOX Options Exchange LLC for Registration as a National Securities Exchange Findings, Opinion, and Order of the Commission.

20 <u>Supra</u> n.19 at 26335.

executions of quotes and orders that are on the BOX Book prior to a PIP Broadcast against a PIP Order will also satisfy the conditions of the Rule.

Under the proposed rule change, a PIP Order with a matching Primary Improvement Order submitted to the PIP would automatically initiate a PIP. Any Improvement Orders at a better price submitted during the PIP will be executed with the PIP Order, as described above, with Public Customer orders at that price having priority. If at the conclusion of the PIP, there is any remaining unexecuted size of the PIP Order, BOX will "sweep" the BOX Book for quotes and orders at the PIP start price, and the PIP Order remainder will be executed against those orders according to price/time priority.

Rule 11a2-2(T) under the Act provides exchange members with an exemption from the prohibition on principal trading, in addition to the exceptions delineated in the statute. Known as the "effect versus execute" rule, Rule 11a2-2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with the Rule's conditions, a member:

(i) may not be affiliated with the executing member;

(ii) must transmit the order from off the exchange floor;

(iii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;[21] and

(iv) with respect to an account over which the member has investment discretion, neither the member nor his associated person may retain any compensation in connection with effecting the transaction except as provided in the Rule.[22]

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21 The member may, however, participate in clearing and settling the transaction.

22 17 CFR 240.11a2-2(T)(a)(2).

The Commission has stated that these four requirements of the Rule are "designed to put members and non-members on the same footing, to the extent practicable, in light of the purposes of Section 11(a)."[23] If a transaction meets the four conditions of the Rule, it will be deemed to be in compliance with Section 11(a)(1), the protection of investors and the maintenance of fair and orderly markets.[24] For the reasons set forth below, the Exchange believes the structural and operational characteristics of the BOX Book are consistent with the stated objectives of Section 11(a) of the Act, and that all users would be placed on the "same footing", as intended by Rule 11a2-2(T), even where quotes and orders on the BOX Book prior to a PIP execute against the PIP Order.

The Commission has recognized and accommodated the functioning of electronic exchange facilities under the Rule.[25] In addition, the Commission and its staff have permitted exchanges to sponsor innovative trading systems in reliance on the Rule, based on the exchanges' representations that such facilities, by design, do not provide any special time and place advantage to members.[26] In particular, the Commission has stated, in the context of certain

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[23] April 1978 Release at 18560.

[24] 17 CFR 240.11a2-2(T)(e).

[25] See Securities Exchange Act Release Nos. 61152 (December 10, 2009), 74 FR 66699 (December 16, 2009) (File No. 10-191) (Findings, Opinion, and Order of the Commission In the Matter of the Application of C2 Options Exchange, Incorporated for Registration as a National Securities Exchange) ("C2 Approval Order") at note 170; 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (File No. SR-NASDAQ-2007-004) (approval order concerning the establishment of the NASDAQ Options Market LLC ("NOM")) ("NOM Approval Order"); Order approving the rules of the Boston Options Exchange, supra n.12; 54552 (September 29, 2006) (AMEX AEMI trading system), 71 FR 59546 (October 10, 2006); 54550 (September 29, 2006), 71 FR 59563 (October 10, 2006) (Chicago Stock Exchange trading system); 54528 (September 28, 2006), 71 FR 58650 (October 4, 2006) (International Securities Exchange trading system); and 49747 (May 20, 2004), 69 FR 30344 (May 27, 2004) (AMEX electronic options trading system).

[26] See e.g., Securities Exchange Act Release No. 44983 (October 25, 2001) (Archipelago

automated execution systems, that where the execution is performed on an automated basis by the facility itself, "the member would not retain any ability to control the timing of the execution or otherwise enjoy the kind of special order-handling advantages inherent in being on an exchange floor.[27] The Commission has applied the Rule in a functional manner, taking into account the structural characteristics that distinguish the operation of an automated execution system from traditional exchange floor activities. This approach represents the sensible conclusion by the Commission and its Staff that implementation of Section 11(a) should reflect the "continuing rapid pace of economic, technological and regulatory changes in the market."[28]

Application of the Rule to quotes and orders on the BOX Book prior to the PIP that execute with the PIP Order

In light of the automated execution of orders submitted to BOX, no Options Participant will enjoy any special control over the timing and execution or special order handling advantages in effecting transactions in orders submitted to the BOX Book. All orders are processed for execution by computer, rather than being handled manually by an Options Participant. Because these processes prevent Options Participants from gaining any time and place advantage once an

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Exchange), citing Letter from Paula R. Jenson, Deputy Chief Counsel, Division of Market Regulation, SEC, to Kathryn L. Beck, Senior Vice President, Special Counsel and Antitrust Compliance Officer, Pacific Exchange, Inc. (October 25, 2001)("Arca Letter"); Letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Edith Hallahan, Associate General Counsel, Philadelphia Stock Exchange, Inc. (March 24, 1999) ("VWAP Letter"); Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC, to David E. Rosedahl, PCX (November 30. 1998) ("OptiMark Letter"); Letter from Brandon Becker, Director, Division of Market Regulation, SEC, to George T. Simon, Partner, Foley & Lardner (November 30, 1994) ("Chicago Match Letter"); Securities Exchange Act Release No. 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (NYSE's Off-Hours Trading Facility (October 25, 2001).

[27] 1979 Release, supra n. 7 at 6087, n. 35

[28] 1979 Release, supra n. 7 at 6087.

order is submitted to BOX, the Exchange believes that the BOX Book process satisfies three of the four conditions of the Rule, as well as the general policy objectives of Section 11(a) of the Act. Of course, as discussed below, BOX Options Participants relying on the Rule also must comply with the fourth condition of the Rule with respect to discretionary accounts, and the Exchange will enforce this requirement pursuant to its obligation under Section 6(b)(1) of the Act to enforce compliance with the federal securities laws.

(i) Execution Through Unaffiliated Member

The Rule's first condition is that the order be executed by an exchange member that is unaffiliated with the member initiating the order.[29] The Commission has repeatedly stated that this requirement is satisfied when automated exchange facilities, such as BOX, are used, so 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 system.[30] In considering the operation of NOM and C2, the Commission noted, while there is no independent executing exchange member, the execution of an order is automatic once it has been transmitted to the system.[31] Because the design of these systems ensures members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T).[32]

This principle is directly applicable to the BOX Book, including the quotes and orders on the Book prior to a PIP that may execute against the PIP Order. The design of the BOX Book

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29 17 CFR 240.11a2-2(T)(a)(2)(i).

30 See e.g., C2 Approval Order and NOM Approval Order, supra n. 25, and Order approving rules of the Boston Options Exchange, supra n. 12.

31 See, NOM Approval Order and C2 Approval Order.

32 Id.

ensures that broker-dealers do not have any special or unique trading advantages in handling their orders after transmission. Accordingly, the Exchange believes that a broker-dealer effecting a transaction through the BOX Book, even where the quote or order on the Book prior to a PIP executes against the PIP Order, satisfies the requirement for execution through an unaffiliated member.

The design of BOX ensures that no BOX Options Participant will enjoy any special control over the timing of execution or special order handling advantages after order transmission. All orders on the BOX Book and through the PIP, are centrally processed and executed automatically by BOX. Specifically, orders sent to BOX will be transmitted from remote terminals directly to the system by electronic means. Once an order is submitted to the BOX Book, the order is executed against another order based on the established matching algorithms for the Book. And, as proposed, those quotes and orders on the Book prior to a PIP, may trade with the PIP Order, or will execute when orders or quotations on BOX match one another based on price/time priority. The execution does not depend on the Options Participant but rather upon what other orders are entered into BOX at or around the same time as the subject order, what orders are on the BOX Book, or if a PIP is initiated, and where the order is ranked based on the priority ranking algorithm. At no time following the submission of an order to the BOX Book is an Options Participant able to acquire control or influence over the result or timing of order execution. Accordingly, Participants do not control or influence the result or timing of orders submitted to the BOX Book, even if such an order were to match with the PIP Order.

(ii) Off-Floor Transmission

The Rule requires that orders for a covered account transaction be transmitted from off the exchange floor.[33] Again, the Commission has considered this requirement in the context of various automated trading and electronic order-handling facilities operated by national securities exchanges.[34] In these contexts, the Commission determined that a covered account order sent through such an exchange facility would be deemed to be transmitted from off the floor. Like these other automated systems, orders sent to BOX, regardless of where it executes within the BOX system, including the Book or the PIP, will be transmitted from remote terminals directly to BOX by electronic means. OFPs and BOX Market Makers will only submit orders and quotes to BOX from electronic systems from remote locations, separate from BOX. There are no other Options Participants that are able to submit orders to BOX other than OFPs or Market Makers. Therefore, the Exchange believes that Participants' orders electronically received by BOX satisfy the off-floor transmission requirement for the purposes of the Rule.[35]

(iii) Non-Participation in Order Execution

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33 17 CFR 240.11a2-2(T)(a)(2)(ii).

34 See e.g., Release Nos. 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (File Nos. SR-NYSE-90-52 and SR-NYSE-90-53) (regarding NYSE’s Off-Hours Trading Facility); 61419 (January 26, 2010), 75 FR 5157 (February 1, 2010) (SR-BATS-2009-031) (approving BATS options trading); 59154 (December 28, 2008), 73 FR 80468 (December 31, 2008) (SR-BSE-2008-48) (approving equity securities listing and trading on BSE); NOM Approval Order; 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 1979 Release.

35 The Commission has not considered the lack of a traditional physical floor to be an impediment to the satisfaction of the off-floor requirement. See, e.g., 1979 Release.

The Rule further provides the exchange member and his associated person not participate in the execution of the order once it has been transmitted.[36] This requirement originally was intended to prevent members with their own floor brokers from using those persons to influence or guide their orders' executions.[37] A member is not precluded from canceling or modifying orders, or from modifying instructions for executing orders, after they have been transmitted; provided, however, such cancellations or modifications are transmitted from off the exchange floor.[38]

In analyzing the application of the non-participation requirement to automated execution facilities, the Commission has specifically noted in regard to BOX that the execution does not depend on the Participant but rather upon what other orders are entered into BOX at or around the same time as the subject order, what orders are on the BOX Book, and where the order is ranked based on the priority ranking and execution algorithm.[39] Based on prior Commission interpretations, orders submitted electronically to the BOX Book will similarly meet the non-participation requirement. Upon submission to BOX, an order is executed against another order on the BOX Book or with the PIP Order based on an established matching algorithm. The execution does not depend on the Participant but rather upon what other orders are entered into BOX at or around the same time as the subject order, what orders are on the BOX Book, whether a PIP is initiated, and where the order is ranked based on the priority ranking algorithm. At no time following the submission of an order to the BOX Book is an Options Participant able to acquire control or influence over the result or timing of order execution. Accordingly,

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36 17 CFR 240.11a2-2(T)(a)(2)(iii).

37 See generally April 1978 Release, supra n. 7.

38 Id.

39 See Order approving rules of Boston Options Exchange, supra n. 12.

Participants do not control or influence the result or timing of orders submitted to BOX, even if their order on the Book may execute with a PIP Order. As such, the Exchange believes the non-participation requirement is met when orders are executed automatically on the BOX Book.

(iv) Non-Retention of Compensation

Finally, the exemption in Rule 11a2-2(T) states, in the case of a transaction effected for an account with respect to which an exchange member or an associated person thereof exercises investment discretion, neither the member nor any associated person thereof, may retain any compensation in connection with effecting the transaction without the express written consent of the person authorized to transact business for the account, given in accordance with the Rule.[40] As a prerequisite for BOX usage, if a Participant is to rely on Rule 11a2-2(T) for a covered account transaction, the Participant must comply with the limitations on compensation set forth in the Rule.[41]

The Exchange believes that orders executed on the BOX Book, including those on the Book prior to a PIP that may execute against a PIP Order, would satisfy the requirements of the "effect versus execute" rule as well as the general policy objectives of Section 11(a) of the Act. Additionally, the Exchange believes that BOX Options Participant executions that occur through the BOX PIP, would continue to be consistent with the requirements in Section 11(a)(1)(G) and Rule 11a1-1(T) under the Act. Further, the Exchange believes the policy concerns Congress sought to address in Section 11(a) of the Act[42], the time and place advantage members on exchange floors have over non-members off the floor and the general public, are not present for

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[40] 17 CFR 240.11a2-2(T)(a)(2)(iv).

[41] See Exchange Rule 4140.

[42] 15 U.S.C. 78k(a).

these various transactions entered into BOX where it is executed on the BOX Book or through the PIP.

The Exchange believes that the proposed rule change is also consistent with Section 6(b)(8) of the Act in that it does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the Exchange believes that the proposal will result in increased liquidity available at improved prices, with competitive pricing outside the control of the Initiating Participant. The proposed rule change should promote and foster competition and provide more options contracts with the opportunity for price improvement. As a result of the increased opportunities for price improvement, the Exchange believes that Participants will increasingly use PIP so that more customer orders are provided the opportunity to receive price improvement over the NBBO.

The Exchange notes that submitting orders to the PIP is voluntary for BOX Options Participants. Additionally, the Exchange notes that several competing options exchanges offer mechanisms similar to the PIP, to which any market participant may choose to submit its matched customer orders. Based on all of the above, the Exchange believes the proposed rule change does not place an undue burden on competition.

B. <u>Self-Regulatory Organization's Statement on Burden on Competition</u>

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. Specifically, the Exchange believes that the proposal will result in increased liquidity available at improved prices, with competitive pricing outside the control of the Initiating Participant. The proposed rule change should promote and foster competition and provide more options contracts with the opportunity for price improvement. As a result of the increased opportunities for price improvement, the Exchange believes that Participants will increasingly use PIP so that more customer orders are provided the opportunity to receive price improvement over the NBBO.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

A. by order approve or disapprove such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-BOX-2012-003 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 No. SR-BOX-2012-003. 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 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 available publicly. All submissions should refer to File No. SR-BOX-2012-003 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.[43]

Kevin M. O'Neill
Deputy Secretary

[43] 17 CFR 200.30-3(a)(12).