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VIA ELECTRONIC SUBMISSION AND
OVERNIGHT DELIVERY

February 25, 2013

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: File No. SR-BOX-2013-06

Dear Ms. Murphy:

NYSE Euronext appreciates the opportunity to comment on the proposed rule change of BOX Options Exchange LLC ("BOX") to list and trade option contracts overlying 1,000 shares of the SPDR S&P 500 Exchange Traded Fund ("SPY").[1] As the operator of two options exchanges, NYSE Arca Inc. and NYSE Amex Options LLC (which operates the options business of NYSE MKT LLC), we generally support efforts to provide investors with improved tools to hedge risk using options. In this instance, however, we feel that the BOX Proposal contains elements that are detrimental to both individual investors and the options National Market System as a whole, creates a two-tiered market in SPY options that will encourage internalization at the expense of quoted markets, makes unsubstantiated claims, will lead to investor confusion, and lacks important details necessary to understand how these products will be listed and traded. In light of these concerns, we believe that the Commission should disapprove the BOX Proposal.

I. Differing Tick Sizes Between Standard and Jumbo SPY Options Will Permit Trade-Throughs and Disadvantage Investors

The filing is silent as to the minimum price variation ("MPV") that will be applicable to the option contracts overlying 1,000 shares of SPY ("Jumbo SPY options"). Without knowing the MPV of the Jumbo SPY options, market participants cannot understand how the new product will trade. Presently, all series, regardless of premium, in regular SPY options are quoted and traded in one-cent MPVs. BOX proposes to treat SPY as a separate product, noting "that price protection would not apply across standard and Jumbo SPY options on an intramarket basis."[2] The rationale given for this is BOX's belief that "because of the liquidity in SPY and options on SPY, existing market forces should keep the prices

[1] *See* Securities Exchange Act Release No. 68759 (January 29, 2013) (SR-BOX-2013-06) ("BOX Proposal").

[2] *See id*.

between standard contracts and Jumbo SPY contracts consistent."[3] Absent any discussion in their filing about the MPV applicable to Jumbo SPY options, however, this conclusion is not justified.

In particular, if BOX, by treating SPY Jumbo options as a separate product, intends to impose $0.05 and $0.10 tick sizes for Jumbo SPY options, then the marketplace will have no ability to provide tight and competitive markets in SPY Jumbo options using standard SPY options as a reference. Consider the following example where the regular SPY contract has an MPV of $0.01 and the Jumbo SPY contract has MPVs of $0.05 and $0.10:

Contract	Bid Size	Bid Price	Ask Price	Ask Size
Regular SPY	500	$3.13	$3.15	500
Jumbo SPY	50	$3.10	$3.20	50

In this example, the Jumbo SPY contracts are priced with a substantially wider bid/ask spread than the regular SPY, and it is not possible to bring these markets into line given the larger MPV for Jumbo SPY. As a result, any investor who sells a Jumbo SPY option at $3.10 or buys one for $3.20 *is being severely disadvantaged* given the substantially better prices available for equivalent quantities of equivalent instruments through the tight and liquid market in standard SPY options. (It is likely, and of particular concern, that an unsophisticated investor would not always realize that better prices are available for equivalent instruments through the standard SPY options market.)

It is important to note that under this scenario, because standard SPY options are always quoted in $0.01 increments and Jumbo SPY options would trade in increments no smaller than $0.05, an investor who buys or sells SPY Jumbo options by trading against the quoted bid or offer will *almost always* receive an inferior price compared to that readily available through standard SPY options. This product will disadvantage investors on almost every single trade, by design.

Accordingly, BOX should make clear what the MPV for quoting Jumbo SPY options is. If the MPV is not intended to be $0.01 for all series, as is the case with regular SPY options, this filing poses serious challenges for price protections for investors, as well as internalization opportunities that are of equal concern (discussed below).

II. Differing Tick Sizes Between Standard And Jumbo SPY Options Create Unavoidable Internalization Concerns

The BOX Proposal fails to consider whether Jumbo SPY options will be eligible for their price improvement process ("PIP"). If BOX should decide to make Jumbo SPY options eligible for PIP auctions, a different pricing increment is of even greater concern. Consider the same example from above:

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[3] *See supra* note 1.

Contract	Bid Size	Bid Price	Ask Price	Ask Size
Regular SPY	500	$3.13	$3.15	500
Jumbo SPY	50	$3.10	$3.20	50

If Jumbo SPY options were limited to $0.05 and $0.10 MPVs, it would be possible to initiate a PIP on BOX to buy 1 contract for $3.20. If the PIP concludes with best priced interest offering 1 contract at $3.19, the buyer is granted $0.01 in "price improvement" for their 1 contract. But despite this "price improvement," the final price to the buyer is *substantially inferior* compared to simply buying 10 contracts in regular SPY options at the posted offer of $3.15. The BOX Proposal should specify whether PIP functionality will be enabled for Jumbo SPY options. If the proposed Jumbo SPY options would be available for the PIP, the BOX Proposal should specify what is the MPV for quoting and trading, as well as the fees charged to participants – both initiators and respondents – otherwise the wider MPVs for Jumbo SPY options and resulting necessarily wider markets, coupled with high fees for auction respondents, would result in a PIP mechanism that fosters internalization of orders inside artificially-wide markets to the clear detriment of investors.

Importantly, the creation of a second-tier market for internalizing SPY options would also detract from price discovery and discourage aggressive liquidity provision in the *regular* SPY contract (one of the most successful options products ever created). Why would a standard SPY options market maker offer an option at $3.15 if BOX Jumbo SPY options create an opportunity for equivalent options to possibly trade up to $3.20? Instead, the market maker would likely post an offer no better than $3.20 in the standard options, and hope that he or she is at least able to sell equivalent options above $3.15 by trading SPYJ contracts through the auction process.

Note that unlike the case with standard options today, this internalization opportunity *cannot be pre-empted* by aggressive quoting in the displayed market, because with an MPV larger than $0.01, there will be no possibility for market makers to proactively post tighter markets on the screen in order to be entitled to trade at a given price. Providing an incentive for Market Makers to quote more tightly in the displayed market is one of the benefits of the growth in auction mechanisms in recent years; it is entirely lacking in this circumstance.

III. BOX Proposal's "Statutory Basis" Section Makes Unsubstantiated Claims

A. Burden On Competition

In the "Statutory Basis" Section, the BOX Proposal states that the proposed rule change is "consistent with Section 6(b)(8) of the Act in that it does not impose any burden on competition not necessary or appropriate in the furtherance of the Act."[4] No explanation is provided for why this would be the case. The proposed product for options overlaying 1,000 shares is designed specifically for large institutional

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4 *See supra* note 1.

investors and is generally too large for the average retail investor. Thus, there is an acute risk of the BOX Proposal creating a two-tiered market for SPY ETF options: one market for institutional investors and another, separate market for retail investors. The establishment of this two-tiered market creates an unnecessary burden on competition that does not currently exist if a institutional investor were to simply trade 10 standard-sized SPY option contracts. Today, when an institutional investor trades a 10 lot of the standard-sized SPY option contract, it helps foster transparency, and price discovery which directly benefits smaller sized retail investors. If permitted, the Box Proposal will likely result in some of that institutional activity migrating away from the standard-sized SPY option contract to the direct detriment of retail investors. The BOX Proposal should specifically address why creating such a two-tiered market for SPY options is not an undue burden on competition for retail investors in a manner that is consistent with the Act.

B. <u>Lack of Justification for Value as an Investment Tool</u>

Also in the "Statutory Basis" Section, the BOX Proposal states that it will make "options on large blocks of the SPY ETF more available as an investing tool, particularly for institutional investors." Again, no explanation is provided for why this would be the case. Any institutional investor willing to pay $2.00 per contract for 1,000 contracts of a given SPY option is already able to do so in the very liquid, standard-sized SPY options market. Note that BOX in many cases charges high "maker fees" to investors whose resting orders on the BOX order book are executed; it is certainly possible that these high per-contract fees act as a disincentive for investors to display large-size SPY option orders on the BOX. If this is the case, BOX may choose to reduce their fees (NYSE Euronext notes that, on NYSE Amex Options among other exchanges, investors executing trades in the Customer range, including many large institutional investors, pay no transaction fees to trade SPY options). However, creating an entirely new, parallel product with significant market structure problems is not justified.

Further, the opportunity for firms to internalize order flow using the Jumbo SPY options product would very likely mean that only "toxic" order flow with a high degree of adverse selection will trade against the tighter quoted spreads in standard SPY options. When this happens, SPY options Market Makers will have to adjust their models accordingly, inevitably resulting in wider quoted spreads in SPY options. As a result, the BOX Proposal would likely make options on the SPY ETF *less* available as an investing tool for most investors.

It is important to note that unlike Mini options, Jumbo SPY options do not enable any trade to take place that cannot already take place. Mini options allow investors to use listed options to enter a covered write strategy against a position of 10 shares of stock for the first time. Investors who want to enter a covered write against a position of 1,000 shares of stock, however, can already do so simply by trading 10 standard options. Again, creating an entirely new parallel product for these investors does not serve any useful purpose and will foster increased quote traffic and investor confusion.

IV. The BOX Proposal Lacks Sufficient Detail

A. Complex Orders

The BOX Proposal is silent as to the treatment of Jumbo SPY options for purposes of Complex Orders as defined in BOX Rule 15000. Complex Order treatment of the Jumbo SPY options is an important item necessary market participants to know before trading Jumbo SPY options for many reasons including hedging, margin, and arbitrage. If approved, will BOX permit an order to buy 30 regular SPY options while selling 1 Jumbo SPY option to qualify as a Complex Order and therefore be exempt from the trade-through prohibitions found in BOX Rule 15010? This is important given that competitive pressure will likely cause other exchanges to follow suit and list Jumbo SPY options if they should be approved. Lack of clarity on this issue could give rise to differing approaches at each exchange which would create confusion for industry participants.

B. Market Maker Appointments

The BOX Proposal is silent with respect to Market Maker appointments in Jumbo SPY options and consequently Market Maker quoting obligations. If approved, will Jumbo SPY be considered a distinct option class, separate and distinct from standard SPY options to be added separately to a Market Makers appointment? Or, will it automatically become part of a Market Maker's appointment if they have an appointment in the standard SPY options contract and in turn become part of the Market Makers overall quoting obligations for SPY? The approach to be taken should be described in the filing so industry participants have certainty.

V. The BOX Proposal Would Create Confusion and Unnecessary Risk For Retail Investors

The BOX Proposal for Jumbo SPY options may lead to investor confusion. By way of background, the American Stock Exchange traded a 1,000 share deliverable ETF option in the past.[5] Specifically, the Amex traded 100- and 1,000-share deliverable options on the S&P 400 MidCap SPDR ETF until 2000, at which time the 1,000-share deliverable option was delisted. The regular contract traded under the symbol MDY and the 1,000-share deliverable traded under the symbol RDY. The strike setting and premium multiplier used is the same approach in the BOX Proposal; specifically, the regular and 1,000-share deliverable contracts had different symbols, the same strike prices, and different premium multipliers. The Amex received input from clients at that time that this approach was too confusing for investors, and as a result the Exchange delisted the contract. The reason for the confusion was attributable to the manner in which the options chain of quotes displayed the two contracts side by side as seen in the example below:

[5] *See* Release No. 34–40157; File No. SR–Amex–96–44.

Strike	Symbol	Bid Size	Bid Price	Ask Price	Ask Size
200	MDY Mar 15 2013 Call	82	3.30	3.50	66
200	RDY Mar 15 2013 Call	4	3.35	3.50	6
205	MDY Mar 15 2013 Call	92	1.00	1.25	99
205	RDY Mar 15 2013 Call	12	1.00	1.20	2
210	MDY Mar 15 2013 Call	72	.20	.35	5
210	RDY Mar 15 2013 Call	12	.25	.40	51

As can be seen, aside from the difference in the symbols and the different sizes of the contracts available to be bought or sold, there is little to visually distinguish the two contracts. The Amex heard direct feedback from participants looking to execute a covered write who mistakenly sold the RDY calls, as the bid price momentarily seemed to be more attractive, against a long position of 100 shares of stock and consequently ended up being short the equivalent of 900 shares of stock. Conversely we also heard from participants that mistakenly bought RDY calls expecting, for example, to be debited $120 but instead seeing their account debited $1,200 dollars due to the 1,000 multiplier on the premium associated with RDY calls, while incurring substantial unexpected risk. The BOX Proposal carries the same risk without offsetting benefits to the marketplace. The Exchange notes that a related proposal from NYSE Amex to list SPY options delivering 1,000 shares of the SPY ETF in 2010 would have reduced the risk of this sort of investor confusion by using a contract multiplier of 100 but strike prices and option premiums that were ten times larger than standard SPY options, making the difference between two corresponding series apparent by inspection. This filing was subsequently withdrawn for other reasons, including potential concerns about several of the points spoken to elsewhere herein.

V. The Approval of Mini Options Does Not Address Concerns about the BOX Proposal

A. <u>Unlike Mini Options, Jumbo Options Add No Value to the Marketplace</u>

In contrast to the BOX Proposal, the Mini options product adds value to the marketplace. Retail investors in particular are "priced out" of many high dollar securities. This is evidenced by the large amount of odd lot trading that takes place in high dollar securities. For example, a recent study found that "the emergence of high-priced stocks such as Google, where trading a round-lot requires an investment of $50,000 or more, has resulted in odd-lots constituting a significant fraction of trade for a subset of important stocks in the market."[6] Mini options are intended to give investors the ability to trade options while risking less capital, something not previously possible. Jumbo options, however, offer nothing new: an investor who wants to make a larger trade than permitted by executing a single contract can, of course, simply trade more contracts today.

[6] *See* "What's Not There: The Odd Lot Bias In TAQ Data", March 2012, O'Hara, Yao and Ye.

B. Costs of Potential Investor Confusion Are Much Larger with Jumbo Options

NYSE Euronext notes that the Mini options methodology is similar in approach to the BOX Proposal, albeit scaled in the opposite direction. Specifically, Mini options use a different symbol, maintain the same strike prices as the regular option, and use a different multiplier (10) on the premium. The concerns with investor confusion highlighted earlier still exist with Mini options; however, the consequences of selling a Mini option instead of a standard contract are much less severe. For example, when executing a covered write, an investor would end up net long 90 shares of stock if they inadvertently sell a Mini call option, whereas the same investor would end up net short 900 shares of stock if they inadvertently sell a Jumbo call option. Similarly, an investor who mistakenly purchases a Mini option might be surprised to find their account debited $20 for an option offered at $2 on the screen, but will likely be much less surprised than the investor who inadvertently purchases a Jumbo option who finds their account debited $2000 for an option offered at $2 on the screen.

VI. Conclusion

As explained above, NYSE Euronext believes the BOX Proposal contains elements that are detrimental to both individual investors and the options National Market System as a whole, creates a two-tiered market in SPY options that will encourage internalization at the expense of quoted markets, makes unsubstantiated claims, will lead to investor confusion, and lacks important details necessary to understand how these products will be listed and traded. Further, the BOX Proposal would likely lead to investor confusion and greatly increased quote traffic without any offsetting benefit, as the BOX Proposal isn't offering investors anything that can't already be obtained in the marketplace simply by trading more contracts of standard SPY options. In light of these concerns, we believe that the Commission should disapprove the BOX Proposal.

We appreciate the Commission's consideration of our comments. If the Commission or its Staff has any questions, please feel free to contact Christopher Twomey, Senior Counsel, at 212-656-5005, or Mike Babel, Vice President, at (212) 656-4744.

Sincerely,

Janet McGinness

cc: John Ramsay, Director of Trading and Markets
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