

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-81292; File No. SR-BOX-2016-48)

August 2, 2017

Self-Regulatory Organizations; BOX Options Exchange LLC; Order Approving a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, to Adopt Rules for an Open-Outcry Trading Floor

I. Introduction

On November 16, 2016, BOX Options Exchange LLC (the “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 adopt rules for an open-outcry trading floor. The proposed rule change was published for comment in the Federal Register on December 05, 2016.³ The Commission received three comment letters on the proposed rule change.⁴ On January 10, 2017, the Commission extended the time period within which to approve, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to March 05, 2017.⁵ On February 21, 2017, the Commission received a response letter from the Exchange, as well as Amendment No. 1 to the proposed rule change.⁶ On March 1, 2017, the Commission

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 79421 (November 29, 2016), 81 FR 87607 (“Notice”).

⁴ See letters to Brent J. Fields, Secretary, Commission, from Angelo Evangelou, Deputy General Counsel, The Chicago Board Options Exchange, Inc. (“CBOE”), dated January 10, 2017 (“CBOE Letter I”); Steve Crutchfield, Head of Market Structure, CTC Trading Group, LLC (“CTC Trading”), dated December 31, 2016 (“CTC Letter I”); and Joan C. Conley, Senior Vice President and Corporate Secretary, The Nasdaq Stock Market LLC (“Nasdaq”), dated December 22, 2016 (“Nasdaq Letter I”).

⁵ See Securities Exchange Act Release No. 79768, 82 FR 4956 (January 17, 2017).

⁶ See letter to Brent J. Fields, Secretary, Commission, from Lisa J. Fall, President,

instituted proceedings to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.⁷ In response to the Order Instituting Proceedings, the Commission received five additional comment letters.⁸ On May 17, 2017, the Exchange filed Amendment No. 2 to the proposed rule change, which replaced and superseded the original filing, as modified by Amendment No.1, in its entirety.⁹ On May 18, 2016, the Commission extended the time period for Commission action on the proceedings to determine whether to disapprove the proposed rule change to August 2, 2017.¹⁰ Amendment No. 2 was published for comment in the Federal Register on May 23, 2017.¹¹ On May 25, 2017, the Commission received a second response letter from the Exchange.¹² The Commission received two comment letters in response to the publication of Amendment No. 2.¹³ On July 14, 2017, the Commission

Exchange, received February 21, 2017 (“BOX Response Letter I”), and Amendment No. 1, dated February 21, 2017.

⁷ See Securities Exchange Act Release No. 80134, 82 FR 12864 (March 7, 2017) (“Order Instituting Proceedings”).

⁸ See letters to Brent J. Fields, Secretary, Commission, from Angelo Evangelou, Deputy General Counsel, CBOE, dated April 21, 2017 (“CBOE Letter II”); Steve Crutchfield, Head of Market Structure, CTC Trading, dated April 13, 2017 (“CTC Letter II”); John Kinahan, CEO, Group One Trading, LP, dated April 11, 2017 (“Group One Letter”); Elizabeth King, General Counsel and Corporate Secretary, New York Stock Exchange, dated March 28, 2017 (“NYSE Letter”); and Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, dated March 27, 2017 (“Nasdaq Letter II”).

⁹ See Amendment No. 2, dated May 17, 2017.

¹⁰ See Securities Exchange Act Release No. 80719, 82 FR 23935 (May 24, 2017).

¹¹ See Securities Exchange Act Release No. 80720 (May 18, 2017), 82 FR 23657 (“Notice of Amendment No. 2”).

¹² See letter to Brent J. Fields, Secretary, Commission, from Lisa J. Fall, President, Exchange, received May 25, 2017 (“BOX Response Letter II”).

¹³ See letters to Brent J. Fields, Secretary, Commission, from Steve Crutchfield, Head of Market Structure, CTC Trading, dated July 10, 2017 (“CTC Letter III”); and Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, dated July 6, 2017 (“Nasdaq Letter III”).

received a third response letter from the Exchange.¹⁴ This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2.

II. Description of the Proposed Rule Change, as Modified by Amendment Nos. 1 and 2

The Exchange proposes to adopt rules that would allow for open-outcry trading on BOX's physical trading floor, located in Chicago ("Trading Floor") as described below.¹⁵

A. BOX Floor Procedure

The Exchange proposes to allow two categories of market participants ("Floor Participants")¹⁶ to transact business on the Trading Floor.¹⁷ One of these categories of market participants consists of individuals ("Floor Broker"¹⁸) who will be registered as such with the Exchange and who will be permitted to accept and handle options orders, including representing such orders on the Trading Floor and entering those orders using the BOX Order Gateway ("BOG")¹⁹ for execution in the Exchange's automated trading system (the "Trading Host").²⁰ The second category of market participants consists of Options Participants of the Exchange located on the Trading Floor who receive permission from the Exchange to trade in options for their own account ("Floor Market Makers").²¹

Contemporaneously upon receipt of an order and prior to the announcement of an order in the trading crowd, a Floor Broker wishing to execute an order will be required to record

¹⁴ See letter to Brent J. Fields, Secretary, Commission, from Lisa J. Fall, President, Exchange, received July 14, 2017 ("BOX Response Letter III").

¹⁵ See proposed BOX Rule 100(a)(67).

¹⁶ See proposed BOX Rule 100(a)(26).

¹⁷ See proposed BOX Rule 100(a)(67).

¹⁸ See proposed BOX Rule 7540.

¹⁹ See proposed BOX Rules 100(b)(2) and 7580(e).

²⁰ See BOX Rule 100(a)(66).

²¹ See proposed BOX Rule 8510(b)

certain information about the order in the Floor Broker’s order entry mechanism.²² Specifically, the Floor Broker will be required to record: (i) the order type and order receipt time; (ii) the option symbol; (iii) buy, sell, cross or cancel; (iv) call, put, complex (i.e., spread, straddle), or contingency order; (v) number of contracts; (vi) limit price or market order or, in the case of a multi-leg order, net debit or credit, if applicable; (vii) whether the transaction is to open or close a position; and (viii) the Options Clearing Corporation clearing number of the broker-dealer that submitted the order.²³

The Floor Broker will then be required to ascertain that at least one Floor Market Maker is present in the Crowd Area²⁴ and announce the order to the trading crowd, in a process called open outcry.²⁵ During open outcry, Floor Market Makers physically located in the Crowd Area will be permitted to express interest in trading against the initiating order.²⁶ To do so, a Floor Market Maker will be required to verbalize that he is “in” after a Floor Broker announces an order, even if a Floor Market Maker had previously provided a valid quote prior to the Floor Broker’s announcement of the order.²⁷ A Floor Market Maker will be considered “out” on a bid

²² See proposed BOX Rule 7580(e).

²³ See proposed BOX Rule 7580(e)(1).

²⁴ See proposed BOX Rules 100(a)(67) and 7580(a).

²⁵ See proposed BOX Rules 7600(b) and 7580(e)(2). This will be required whether the Floor Broker is representing a single-sided order and is soliciting contra-side interest, or the Floor Broker has sufficient interest to match against the order already. See proposed BOX Rule 7580(e)(2).

²⁶ See proposed BOX Rule IM-8510-2(b). It will be considered conduct inconsistent with just and equitable principles of trade for any Floor Broker or Floor Market Maker to intentionally disrupt the open outcry process. See proposed BOX Rule IM-7580-4.

²⁷ A Floor Broker will be permitted to request a market prior to announcing an order on the Trading Floor (“Market Probe”). When a Floor Broker announces a Market Probe, any responses from Floor Participants will be public to all Floor Participants. When a Floor Broker conducts a Market Probe, he must probe all Floor Participants. See Notice of Amendment No. 2, supra note 11, at 23662 n.75.

or offer if he does not affirmatively respond to the Floor Broker who announces the order, provided that the Floor Broker will be required to give a Floor Participant a reasonable amount of time within which to respond.²⁸

Under the proposal, after an order is announced to the trading crowd, the Floor Broker will be permitted to submit a Qualified Open Outcry Order (“QOO Order”) through the BOG to the Trading Host for execution. QOO Orders are two-sided orders²⁹ comprised of an “initiating side” (the “agency order”), which must be filled in its entirety, and a “contra-side,” which must guarantee the full size of the agency order.³⁰ The order announced by the Floor Broker on the Trading Floor will be considered the agency order. At the time of the announcement, the Floor Broker may be representing only that agency order (i.e., a single-sided or unmatched order) on the Trading Floor in order to seek a contra-side, or the Floor Broker may already have a contra-side that guarantees the full size of that agency order.³¹ If the Floor Broker does not have a contra-side and is therefore soliciting interest from the trading crowd when the initiating side is announced or to the extent the trading crowd provides a better price, the contra-side of the QOO Order will be the solicited interest from the trading crowd;³² otherwise, the Floor Broker interest

²⁸ See proposed BOX Rule 100(b)(5). A “reasonable amount of time” will be interpreted on a case-by-case basis by an Options Exchange Official, based on the current market conditions and trading activity on the Trading Floor. See *id.*

²⁹ A Floor Participant who wishes to place a limit order on the BOX Book will be required to submit such order electronically. See proposed BOX Rules IM-7580-1 and IM-8510-8. The BOX Book is defined as the electronic book of orders on each single option series maintained by the Trading Host. See BOX Rule 100(a)(10).

³⁰ See proposed BOX Rule 7600(a)(1).

³¹ See proposed BOX Rule IM-7600-4. If a Floor Broker is holding two agency orders, he will choose which order will be the initiating side. See proposed BOX Rule 7580(e)(2).

³² See proposed BOX Rule 7600(a)(1).

will be the contra-side of the QOO Order, subject to the allocation procedure as described below.³³

For a non-complex QOO Order, the execution price must be equal to or better than the National Best Bid or Offer (“NBBO”).³⁴ A Complex QOO Order may be executed at a price without giving priority to equivalent bids or offers in the individual series legs on the initiating side, provided at least one options leg betters the corresponding bid or offer on the BOX Book by at least one minimum trading increment.³⁵ Under the proposed rules, an Options Exchange Official³⁶ will be required to certify that the Floor Broker adequately announced the QOO Order to the trading crowd.³⁷

Once a QOO Order is submitted through the BOG, it would be immediately processed by the Trading Host.³⁸ The order would be executed based on market conditions at the time that the order is received by the Trading Host and in accordance with the Exchange’s rules.³⁹ If there is an ongoing auction in the option series when the QOO Order is received by the Trading Host the QOO Order will be rejected.⁴⁰

³³ See id.

³⁴ See proposed BOX Rule 7600(c).

³⁵ See proposed BOX Rule 7600(c).

³⁶ See proposed BOX Rule 100(b)(6). The QOO Order will not be deemed executed until it is processed by the Trading Host. See proposed BOX Rule 7600(c).

³⁷ See proposed BOX Rule 7600(b).

³⁸ See proposed BOX Rule 100(b)(2). Under the proposal, orders on the Trading Floor will not route to an away exchange and may not be considered in the determination of the opening price or participate in the opening trade. See proposed BOX Rules 7070(d) and 7600(e).

³⁹ See proposed BOX Rule 7600(a). Once a Floor Broker submits a QOO Order to the BOG, neither the submitting Floor Broker, nor anyone else, will be allowed to alter the terms of the QOO Order. See proposed BOX Rule 7600(c).

⁴⁰ See proposed BOX Rule 7600(a)(5). A Complex QOO Order will not be rejected if there

Under the proposal, the highest bid (lowest offer) in the trading crowd will have priority.⁴¹ If there are two or more bids (offers) for the same options contract that represent the highest bid (lowest offer), priority will be afforded to such bids (offers) in the sequence in which they are made.⁴² If a Floor Broker's bid or offer is accepted by more than one Floor Participant, the Floor Broker will be required to designate the priority order of the Floor Participants based on when each Floor Participant responds.⁴³ Starting with the Floor Participant with first priority, each Floor Participant will be entitled to buy or sell as many contracts as the Floor Broker may have available to trade until the Floor Broker's order has been filled entirely.⁴⁴ However, if bids or offers are made by more than one Floor Participant simultaneously, such bids or offers will be deemed to be on parity and priority will be afforded to them, insofar as practicable, on an equal basis.⁴⁵ If Floor Participants provide a collective response to a Floor Broker's request for a market in order to fill a large order, the order will be allocated pro rata pursuant to proposed BOX Rule 7610(d)(5).⁴⁶ The Floor Broker will be responsible for determining the sequence in

is an ongoing auction in the options series of some, but not all, of the components of the Complex QOO Order. See id.

⁴¹ See proposed BOX Rule 7610(a) and (b).

⁴² See id.

⁴³ See proposed BOX Rule 7610(d)(2).

⁴⁴ See id. For Complex QOO Orders, Floor Participants will not be permitted to give a competing bid or offer for one component of the order to prevent the Complex QOO Order from being executed. See proposed BOX Rule IM-7600-1(d).

⁴⁵ See proposed BOX Rule 7610(d)(4). Each Floor Participant on parity will receive an equal number of contracts, to the extent mathematically possible.

⁴⁶ Specifically, proposed BOX Rule 7610(d)(5) states that if the size of the trading crowd's market, in the aggregate, is less than or equal to the size of the order to be filled, the Floor Participants will each receive a share of the order that is equal to the size of their respective bids. However, if the size of the trading crowd's market exceeds the size of the order to be filled, that order will be allocated on a size pro rata basis, with the Floor Participants in the trading crowd each receiving, to the extent practicable, the percentage of the order that is the ratio of the size of their respective bids or offers to the total size of

which bids or offers are vocalized on the Trading Floor in response to the Floor Broker's bid, offer, or call for a market.⁴⁷

The following BOX Book interest will have priority over the contra-side of the QOO Order: (i) any equal or better priced bids or offers on the BOX Book that were submitted on behalf of persons who are not brokers or dealers in securities ("Public Customers");⁴⁸ (ii) any non-Public Customer bids or offers on the BOX Book that are ranked ahead of such equal or better priced Public Customer bids or offers; and (iii) any non-Public Customer bids or offers on the BOX Book that are priced better than the proposed execution price.⁴⁹ When submitting the QOO Order to the BOG, a Floor Broker may, but will not be required to, provide a "book sweep size."⁵⁰ The book sweep size is the number of contracts, if any, of the initiating side of the QOO Order that the Floor Broker is willing to relinquish to orders and quotes on the BOX Book that have priority pursuant to proposed BOX Rule 7600(c).⁵¹ If the number of contracts on the BOX

all bids or offers.

⁴⁷ See proposed BOX Rule 7610(d)(1). Any disputes regarding a Floor Broker's determination of time priority sequence will be resolved by an Options Exchange Official. See id. An Options Exchange Official may nullify a transaction or adjust its terms if the Official determines the transaction to have been in violation of Exchange's Rules. See id.

⁴⁸ See BOX Rule 100(a)(51).

⁴⁹ See proposed BOX Rule 7600(c). For Complex QOO Orders, the following Complex Order Book interest will have priority: (i) any equal or better priced Public Customer Complex bids or offers on the Complex Order Book or any non-Public Customer Complex bids or offers on the Complex Order Book that are ranked ahead of such equal or better priced Public Customer Complex bids or offers; and (ii) any non-Public Customer bids or offers on the Complex Order Book that are priced better than the proposed execution price. See id.

⁵⁰ See proposed BOX Rule 7600(h).

⁵¹ See proposed BOX Rule 7600(h). Proposed BOX Rule IM-7600-3 states that it will be considered conduct inconsistent with just and equitable principles of trade for any Floor Broker to use the book sweep size for the purpose of violating the Floor Broker's duties and obligations.

Book that have priority over the contra-side of the QOO Order is greater than the book sweep size set by the Floor Broker, then the QOO Order will be rejected.⁵²

The proposed rule change also describes the allocation process for QOO Orders.⁵³ First, under the proposal, the initiating side of the QOO Order will match against any bids or offers on the BOX Book that have priority as outlined above, provided that an adequate book sweep size is provided by the Floor Broker.⁵⁴ The remaining balance, if any, will be matched against the contra-side of the QOO Order, regardless of whether the Floor Broker is ultimately entitled to receive an allocation.⁵⁵ If the QOO Order is of a certain size, which size will be determined by the Exchange on an option by option basis (at a size that may not be less than 500 contracts), the Floor Broker will be entitled to cross, after all equal or better priced Public Customer bids or offers on the BOX Book and any non-Public Customer bids or offers that are ranked ahead of such Public Customer bids or offers are filled, 40% of the remaining contracts in the order.⁵⁶ Next, Floor Participants that respond with interest when the executing Floor Broker announces the QOO Order to the trading crowd will be allocated.⁵⁷ If interest remains, the remaining quantity of the initiating side of the QOO Order will be allocated to the executing Floor Broker.⁵⁸ If the QOO Order executes, the executing Floor Broker will be responsible for providing the

⁵² See proposed BOX Rule 7600(h).

⁵³ See also Notice of Amendment No. 2, supra note 11, at 23668-74 (providing a detailed description and examples of how orders will be allocated).

⁵⁴ See proposed BOX Rule 7600(d)(1) and (2).

⁵⁵ See proposed BOX Rule 7600(d)(3).

⁵⁶ See proposed BOX Rule 7600(f). See also proposed BOX Rule 7600(d)(3)(i). In determining whether a Complex QOO Order satisfies the eligible order size requirement, the Complex QOO Order must contain one leg which, standing alone, is for the eligible size or greater. See proposed BOX Rule IM-7600-1(d).

⁵⁷ See proposed BOX Rule 7600(d)(3)(ii).

⁵⁸ See proposed BOX Rule 7600(d)(3)(iii).

correct allocations of the initiating side of the QOO Order to an Options Exchange Official or his or her designee, if necessary, who will properly record the order in the Exchange's system.⁵⁹

Floor Brokers also will be responsible for handling all orders in accordance with the Exchange's priority and trade-through rules.⁶⁰

The Floor Participants who established the market will have priority over all other orders that were not announced in the trading crowd at the time that the market was established (but not over Public Customer orders on the BOX Book or any non-Public Customer orders that have priority over such Public Customer orders on the BOX Book) and will maintain priority over such orders except for orders that improve upon the market.⁶¹

B. Additional Floor Broker Obligations

A Floor Broker handling an order will be required to use due diligence to cause the order to be executed at the best price or prices available to him in accordance with the Rules of the Exchange.⁶² All orders provided to Floor Brokers will be considered Not Held Orders⁶³ unless

⁵⁹ See proposed BOX Rule 7600(d)(4). The executing Floor Broker must provide the correct allocations to an Options Exchange Official or his or her designee, in writing, without unreasonable delay. See id.

⁶⁰ See proposed BOX Rule 7600. Proposed BOX Rule 8510(h)(4) provides that it will be considered conduct inconsistent with just and equitable principles of trade for: (i) a Floor Broker to allocate orders other than in accordance with the Exchange's priority rules applicable to floor trades; (ii) a Floor Participant to enter into any agreement with another Floor Participant concerning allocation of trades; or (iii) a Floor Participant to harass, intimidate or coerce another Floor Participant to make or refrain from making any complaint or appeal.

⁶¹ See proposed BOX Rule IM-7600-1(c). It will be the responsibility of the Floor Participant that established the market to alert the Floor Broker of the fact that the Floor Participant has priority when an order is announced. See id.

⁶² See proposed BOX Rule 7570.

⁶³ See proposed BOX Rule 7600(g). A Not Held Order gives a Floor Broker discretion as to the price or time at which such order will be executed. See id.

otherwise specified by the Floor Broker's client.⁶⁴ However, the proposed rule change would prohibit Floor Brokers from engaging in certain discretionary transactions.⁶⁵ An Options Floor Broker handling a contingency order that is dependent upon the price of the underlying security will be responsible for satisfying the dependency requirement on the basis of the last reported price of the underlying security in the primary market that is generally available on the Trading Floor at any given time.⁶⁶

Floor Brokers will be required to make reasonable efforts to ascertain whether each order entrusted to them is for the account of a Public Customer or a broker-dealer.⁶⁷ For broker-dealer orders, a Floor Broker must advise the trading crowd of the fact that it is an order for the account of a broker-dealer prior to open outcry and prior to submitting the order for execution, as well as note such fact in the Floor Broker's system.⁶⁸ Additionally, a Floor Broker will be required to inform the trading crowd when he is representing an order for a Market Maker and will be required to comply with proposed BOX Rules IM-8510-6 and IM-8510-9.⁶⁹ For Public

⁶⁴ See proposed BOX Rule IM-7580-3.

⁶⁵ See proposed BOX Rules 7590, IM-7590-1 and IM-7590-2. Proposed BOX Rule 7590 will prohibit Floor Brokers from executing or causing to be executed any order or orders for which the Floor Broker is vested with discretion as to: (i) the choice of the class of options to be bought or sold; (ii) the number of contracts to be bought or sold; or (iii) whether any such transaction shall be one of purchase or sale. Proposed BOX Rule IM-7590-1 will prohibit the holding or acceptance of certain orders that could be interpreted as allowing the Floor Broker discretion with respect to whether to purchase or sell options. Proposed BOX Rule IM-7590-2 will prohibit Floor Brokers from exercising any discretion with respect to the order of an options market maker registered on any exchange.

⁶⁶ See proposed BOX Rule 7580(b).

⁶⁷ See proposed BOX Rule IM 7580-2.

⁶⁸ See proposed BOX Rule IM-7580-2.

⁶⁹ See proposed BOX Rule 7580(d). Proposed BOX Rule 8510-6 will allow the Exchange to temporarily limit the number of Floor Market Makers in the trading crowd who are establishing or increasing a position when the interests of a fair and orderly market

Customer orders, a Floor Broker must disclose all securities that are components of the Public Customer order which is subject to crossing before requesting bids and offers for the execution of all components of the order.⁷⁰

C. Floor Market Makers

Proposed BOX Rule 8500(a) will require a Floor Market Maker to register as a Market Maker with the Exchange, and such registration could be revoked or suspended at any time. The proposed rules will require Floor Market Maker transactions to constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market.⁷¹

Additionally, a Floor Market Maker will be prohibited from effecting on the Exchange purchases or sales of any option in which such Floor Market Maker is registered, for any account in which he or his Options Participant is directly or indirectly interested, unless such dealings are reasonably necessary to permit such Floor Market Maker to maintain a fair and orderly market.⁷²

A Floor Market Maker will have certain affirmative obligations in classes of options contracts to which the Floor Market Maker is assigned.⁷³ Floor Market Makers will be subject to

require such limitation. Proposed BOX Rule 8510-9 will prohibit a Floor Market Maker from acquiring a “long” position by pairing off with a sell order before the opening, unless all off-Floor bids at that price are filled.

⁷⁰ See proposed BOX Rule IM-7600-1(a). A Floor Broker crossing a Public Customer order with an order that is not a Public Customer order, when providing for a reasonable opportunity for the trading crowd to participate in the transaction, will be required to disclose the Public Customer order that is subject to crossing. See proposed BOX Rule IM-7600-1(e).

⁷¹ See proposed BOX Rule 8510(a).

⁷² See proposed BOX Rule 8500(c).

⁷³ See proposed BOX Rule 8510(d). Proposed BOX Rule 8610(e) describes the obligations of a Floor Market Maker with respect to classes of options to which the Floor Market Maker is not appointed. The obligations of a Floor Market Maker with respect to those classes of options to which he is assigned will take precedence over his other activities. See proposed BOX Rule IM-8510-1.

a Continuous Open Outcry Quoting Obligation, which will require Floor Market Makers to provide a two-sided market complying with the quote spread parameter requirements contained in proposed Rule 8510(d)(1), in response to any request for a quote by a Floor Broker or Options Exchange Official.⁷⁴ Floor Market Maker quotations must be in a size of at least 10 contracts.⁷⁵ Additionally, Floor Market Makers will be subject to a maximum option price change, and will not be permitted to bid more than \$1 lower and/or offer more than \$1 higher than the last preceding transaction price for a particular option contract.⁷⁶

The proposed rule change imposes other limitations on Floor Market Makers. Specifically, subject to certain exceptions, no Floor Market Maker will be allowed to initiate an Exchange options transaction while on the Trading Floor for any account in which he has an interest and execute as Floor Broker an off-floor order in options on the same underlying interest during the same trading session, or retain priority over an off-floor order while establishing or increasing a position for an account in which he has an interest while on the Trading Floor of the Exchange.⁷⁷ The proposed rule change also describes what Floor Market Maker orders will be considered “on the Floor” and which Floor Market Maker orders will be subject to certain restrictions of the proposed rule change.⁷⁸

D. Options Exchange Officials and Supervision of the Trading Floor

⁷⁴ See proposed BOX Rule 8510(c)(2). Quotations in open outcry may not be made with \$5 bid/ask differentials provided in BOX Rule 8040(a)(7). See proposed BOX Rule 8510(d)(1).

⁷⁵ See proposed BOX Rule 8510(c)(2).

⁷⁶ See proposed BOX Rule 8510(d)(2). This standard will not ordinarily apply if the price per share of the underlying stock or Exchange-Traded Fund Share has changed by more than \$1 since the last preceding transaction for the particular option contract. See *id.*

⁷⁷ See proposed BOX Rule 8510(f) and (g).

⁷⁸ See proposed BOX Rules IM-8510-3(b), IM-8510-4 and IM-8510-5.

Under the proposed rule change, the President of the Exchange and his or her designated staff will be responsible for monitoring: (1) dealings of Floor Participants and their associated persons on the Trading Floor, and of the premises of the Exchange immediately adjacent thereto; (2) the activities of Floor Participants and their associated persons, in addition to establishing standards and procedures for the training and qualification of Floor Participants and their associated persons active on the Trading Floor; (3) all Trading Floor employees of Floor Brokers and Floor Market Makers, and will make and enforce such rules with respect to such employees as may be deemed necessary; (4) all connections or means of communications with the Trading Floor, and may require the discontinuance of any such connection or means of communication when, in the opinion of the President or his or her designee, it is contrary to the welfare or interest of the Exchange; (5) the location of equipment and the assignment and use of space on the Trading Floor; and (6) relations with other options exchanges.⁷⁹

The proposed rule change provides for the designation of Options Exchange Officials. Specifically, any Exchange employee or officer may be designated as an Options Exchange Official and will have the ability to recommend and enforce rules and regulations relating to trading access, order, decorum, health, safety and welfare on the Exchange.⁸⁰ An Options Exchange Official will be required to, among other things, certify that Floor Brokers adequately announce QOO Orders to the trading crowd,⁸¹ resolve disputes regarding a Floor Broker's

⁷⁹ See proposed BOX Rule 100(b)(1). The Exchange states that it will submit a separate filing to the Commission to amend the Exchange's Minor Rule Violation Plan in BOX Rule 12140 to cover minor rule violations on the Trading Floor. The Exchange represents that it will not commence operation of the Trading Floor until the Exchange's Minor Rule Violation Plan has been amended to include violations which may occur on the Trading Floor.

⁸⁰ See proposed BOX Rule 100(b)(6).

⁸¹ See proposed BOX Rule 7600(b).

determination of time priority sequence,⁸² and properly record the allocation of the initiating side of a QOO Order as provided by a Floor Broker.⁸³ Options Exchange Officials will also be allowed to temporarily limit the number of Floor Market Makers in the trading crowd who are establishing or increasing a position when the interests of a fair and orderly market are served by such limitation,⁸⁴ as well as call upon a Floor Market Maker to make a market.⁸⁵

In addition, disputes occurring on and relating to the Trading Floor, if not settled by agreement between the interested Floor Participants, will be settled by an Options Exchange Official.⁸⁶ Options Exchange Officials will have the authority to direct the execution of an order, adjust the transaction terms or Participants to an executed order, or nullify a transaction if the Options Exchange Official determines the transaction to have been in violation of Exchange Rules.⁸⁷ All Options Exchange Official rulings are effective immediately and failure to comply with such a ruling may result in an additional violation.⁸⁸ All Options Exchange Official rulings are reviewable by the Chief Regulatory Officer or his or her designee, and the proposed rule change provides procedures regarding review of rulings by Options Exchange Officials.⁸⁹

E. Clerks

⁸² See proposed BOX Rule 7610(d)(1).

⁸³ See proposed BOX Rule 7600(d)(4).

⁸⁴ See proposed BOX Rule IM-8510-6.

⁸⁵ See proposed BOX Rule 8510(d). See also proposed BOX Rule 7610(d)(3).

⁸⁶ See proposed BOX Rule 7640(a). The Exchange will be permitted to determine that an Options Exchange Official is ineligible to participate in a particular ruling where it appears such Options Exchange Official has a conflict of interest. See proposed BOX Rule IM-7640-1.

⁸⁷ See proposed BOX Rule 7640(b).

⁸⁸ See proposed BOX Rule 7640(c).

⁸⁹ See proposed BOX Rule 7640(e).

The Exchange will permit Clerks – defined as any registered on-floor persons employed by or associated with a Floor Broker or Floor Market Maker and who are not eligible to effect transactions on the Trading Floor as a Floor Market Maker or Floor Broker – on the Trading Floor.⁹⁰ Proposed Rule 7630 sets forth identification requirements, registration requirements, and provisions relating to conduct on the Trading Floor with respect to Clerks.⁹¹ A Floor Broker Clerk will be permitted to enter an order under the direction of a Floor Broker by way of any order handling device.⁹² A Floor Market Maker Clerk will be permitted to communicate verbal market information (i.e., bid, offer, and size) in response to requests for such information, provided that such information is communicated under the direct supervision of his or her Floor Market Maker employer, and such bids and offers are binding as if made by the Floor Market Maker employer.⁹³ All Trading Floor personnel, including clerks, interns, stock execution clerks and any other associated persons, of a Floor Participant not required to register pursuant to proposed Rule 2020(h) must be registered as a “Floor Employee” under “BOX” on Form U4.⁹⁴

F. Communications and Equipment

The Exchange proposes BOX Rule 7660 to govern communications and equipment on the Trading Floor, including registration requirements, restrictions on use, capacity and functionality, recordkeeping requirements and exchange liability. Among other things, the

⁹⁰ See proposed BOX Rule 7630(a).

⁹¹ See proposed BOX Rule 7630. Among other things, proposed BOX Rule 7630 will require Clerks to display prominently at all time badge(s) supplied to them by the Exchange while on the Trading Floor and specifies that Clerks will be primarily located at a workstation assigned to his employer unless the Clerk is (i) entering or leaving the Trading Floor; (ii) transmitting, correcting, or checking the status of an order or reporting or correcting an executed trade; or (iii) supervising other Clerks. See id.

⁹² See proposed BOX Rule 7630(e).

⁹³ See proposed BOX Rule 7630(f)(2).

⁹⁴ See proposed BOX Rule 2020(i).

proposed rule will allow Floor Market Makers to use their own cellular and cordless phones to place calls to any person at any location (whether on or off the Trading Floor) and allow Floor Brokers to use any communication device on the Trading Floor and in the Crowd Area to receive orders, provided that the Exchange's audit trail and record retention requirements are satisfied.⁹⁵ In addition, the Exchange represents that it has established a Communications Devices policy and violations of this policy may result in disciplinary action by the Exchange.⁹⁶ Proposed BOX Rule 7660 and any relevant Exchange policy are intended to apply to all communication and other electronic devices on the Trading Floor, including, but not limited to, wireless, wired, tethered, voice, and data.⁹⁷

G. Other Changes

The Exchange's proposal includes several other provisions relating to the proposed Trading Floor, including Trading Floor hours;⁹⁸ Trading Floor admittance;⁹⁹ the term "on the Floor," which means the Trading Floor, the rooms, lobbies and other premises immediately adjacent thereto made available by the Exchange for use by Floor Participants generally; other rooms, lobbies and premises made available by the Exchange primarily for use by Floor Participants; and the telephone and other facilities in any such place;¹⁰⁰ and the location of Floor Participants on the Trading Floor.¹⁰¹ The proposal also includes provisions relating

⁹⁵ See proposed BOX Rule 7660(h) and (i).

⁹⁶ See proposed BOX Rule IM-7660-1.

⁹⁷ See proposed BOX Rule IM-7660-2.

⁹⁸ See proposed BOX Rule 7500.

⁹⁹ See proposed BOX Rules 7510 and 7520.

¹⁰⁰ See proposed BOX Rule IM-8510-3(a).

¹⁰¹ See proposed BOX Rule IM-8510-7.

generally to Floor Participants, including the registration of Floor Participants;¹⁰² excepting Floor Participants who do not conduct business with the public from brokers' blanket bond requirements;¹⁰³ requiring Floor Participants to procure and maintain liability insurance;¹⁰⁴ generally prohibiting trading for joint accounts without the prior approval of the exchange;¹⁰⁵ prohibiting Floor Participants from relying on an exemption under Section 11(a)(1)(G) of the Act;¹⁰⁶ and procedures governing the resolution of uncompleted trades between Floor Participants.¹⁰⁷ To accommodate new definitions relevant to the proposed Trading Floor, the Exchange is also renumbering certain subparts of Rule 100, Definitions, and making corresponding changes to update cross-references to such definitions where appropriate.¹⁰⁸

H. Trading Floor Data

The Exchange represents that it will provide the Commission with data related to activity on the Trading Floor.¹⁰⁹ Specifically, the Exchange will provide information regarding size, participation, price improvement by spread and trade type, effective spread, Floor Market Maker participation, and BOX Book participation.¹¹⁰ Firm-specific information will be provided to the Commission on a confidential basis each quarter and non-firm specific information will be made available to the public quarterly on the Exchange's website.¹¹¹

¹⁰² See BOX Rule 2020(h).

¹⁰³ See proposed BOX Rule 4180(g).

¹⁰⁴ See proposed BOX Rule 7230(f).

¹⁰⁵ See proposed BOX Rule 7650.

¹⁰⁶ See proposed BOX Rule IM-7600-5.

¹⁰⁷ See proposed BOX Rule 8530(a).

¹⁰⁸ See, e.g., proposed BOX Rules 100, 7130, 7150, 7245.

¹⁰⁹ See Notice of Amendment No. 2, supra note 11, at 23679.

¹¹⁰ See id.

¹¹¹ See id.

III. Discussion and Commission Findings

After careful review and consideration of the comments received, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1 and 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹² In particular, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1 and 2, is consistent with Sections 6(b)(1) and 6(b)(5) of the Act.¹¹³ Section 6(b)(1) of the Act¹¹⁴ requires an exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange. Section 6(b)(5) of the Act¹¹⁵ 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 investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, brokers or dealers.

As previously noted, the Commission received three comment letters on the initial proposed rule change, and one response letter from BOX.¹¹⁶ Subsequently, the Commission

¹¹² 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).

¹¹³ 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78f(b)(5).

¹¹⁴ 15 U.S.C. 78f(b)(1).

¹¹⁵ 15 U.S.C. 78f(b)(5).

¹¹⁶ These comments, as well as BOX's initial response, are described in detail in the Order

received five comment letters on the Order Instituting Proceedings and the proposed rule change as modified by Amendment No. 1, as well as a second response letter from BOX. Of these five comment letters, two urged disapproval of the proposed rule change,¹¹⁷ while the remaining three requested clarity or more specificity on various aspects of the proposal.¹¹⁸ Finally, in response to the publication of Amendment No. 2, two prior commenters submitted additional letters and BOX submitted an additional response letter.¹¹⁹ One of these commenters raised concerns with several aspects of the proposal for which it requested further consideration,¹²⁰ while the other commenter urged disapproval of the proposed rule change, as amended.¹²¹

A. BOX Floor Participation

1. Floor Market Maker Presence Requirement

Four commenters expressed concern that BOX's initial proposal would allow a Floor Broker to execute trades on the Trading Floor when no Floor Market Makers are present.¹²² One commenter argued that options exchange trading floors grew from crowded equities or futures floors and therefore were certain to have robust and active market maker populations.¹²³ The commenter further stated that the lack of rules to ensure robust market maker participation on the proposed Trading Floor would provide a way for internalizers to avoid exposure to market

Instituting Proceedings. See Order Instituting Proceedings, supra note 7.

¹¹⁷ See CBOE Letter II and CTC Letter II, supra note 8.

¹¹⁸ See Group One Letter, Nasdaq Letter II, and NYSE Letter, supra note 8.

¹¹⁹ See Nasdaq Letter III and CTC Letter III, supra note 13 and BOX Response Letter III, supra note 14.

¹²⁰ See Nasdaq Letter III, supra note 13.

¹²¹ See CTC Letter III, supra note 13.

¹²² See CTC Letters I & II, CBOE Letter II, Group One Letter, and Nasdaq Letter II, supra notes 4 and 8.

¹²³ See CTC Letter I, supra note 4, at 4.

makers who might otherwise provide price improvement, which is contrary to investor protection and the public interest.¹²⁴ One commenter stated that allowing orders to be crossed without meaningful exposure to other market participants deprives floor orders of the opportunity for exposure to a bona fide open-outcry auction process.¹²⁵ Another commenter suggested that orders should be exposed to any Floor Participant that is eligible to interact as part of the crossing transaction.¹²⁶ Another commenter argued that any proposed new options trading floor should be required to electronically expose all orders originating on the trading floor to qualified market participants off the trading floor before such orders would be permitted to execute.¹²⁷

One commenter suggested that prior to the commencement of trading, BOX should be required to demonstrate that the Trading Floor is sufficiently populated with market participants, particularly Floor Market Makers, to ensure that a reasonable amount of liquidity exists.¹²⁸ This commenter further noted that a well-populated trading floor is important for fostering price competition.¹²⁹

In response to concerns about the potential for trades to be executed in the absence of a Floor Market Maker on the Trading Floor, BOX submitted Amendment No. 2 to require a Floor Broker to ascertain that at least one Floor Market Maker is present in the trading crowd prior to announcing an order to the trading crowd.¹³⁰ In addition, in response to concerns regarding a

¹²⁴ See id. at 4-5. See also Group One Letter and NYSE Letter, supra note 8.

¹²⁵ See Group One Letter, supra note 8, at 2.

¹²⁶ See NYSE Letter, supra note 8, at 2.

¹²⁷ See CTC Letter I, supra note 4, at 3-4.

¹²⁸ See Nasdaq Letter III, supra note 13, at 3.

¹²⁹ See id. at 2.

¹³⁰ See BOX Response Letter II, supra note 12, at 3. See also Notice of Amendment No. 2, supra note 11, at 23663.

potential lack of order exposure to other Floor Participants, BOX stated that proposed Rules 7580(e)(2) and 7600(b) require all orders from the Trading Floor to be exposed to the trading crowd prior to execution in the Trading Host and to require a Floor Broker to give Floor Participants a reasonable amount of time to respond once an order is announced to the trading crowd.¹³¹ BOX further stated that the proposal has always required orders to be exposed to the trading crowd prior to execution.¹³² In addition, BOX stated that it plans to launch its trading operations on the Trading Floor as soon as the requisite number of Floor Market Makers and Floor Brokers are registered and able to participate on the Trading Floor.¹³³

The Commission notes that the Exchange amended its proposal to require a Floor Broker to ascertain that at least one Floor Market Maker be present in the Crowd Area prior to announcing an order to the trading crowd. The Commission believes that this requirement – along with the BOX’s other amendments to the proposal, such as the changes to the crowd area presence requirement and the Floor Market Maker quoting requirement, described below – are designed to increase the opportunities for another Floor Participant to compete to interact with the orders on the Trading Floor.¹³⁴

2. Crowd Area Presence Requirement

Four commenters raised concerns with the proposed requirement in BOX’s initial proposed rule change that a Floor Market Maker must be physically located in a specific Crowd Area to be deemed participating in the Crowd.¹³⁵ Two commenters expressed concern regarding

¹³¹ See BOX Response Letter II, supra note 12, at 2-3.

¹³² See id.

¹³³ See BOX Response Letter III, supra note 14, at 2.

¹³⁴ See proposed BOX Rule 7580(a).

¹³⁵ See CBOE Letters I & II, CTC Letters I & II, Group One Letter, and NYSE Letter, supra notes 4 and 8.

the proposed rule change's description and application of physical boundary requirements.¹³⁶ One commenter suggested that this aspect of the proposed rule change would limit potential opportunities for market maker price improvement.¹³⁷ Another commenter suggested that the proposal to allow a Floor Market Maker to participate in a crowd only if he or she is physically located in a specific Crowd Area "at the time the order is represented in the crowd" is designed to discourage Floor Market Makers from providing liquidity.¹³⁸ The commenter suggested that the Exchange could instead open a Trading Floor comprised of a single Crowd Area with rules permitting all Floor Market Makers to trade all issues as a means to help ensure opportunities for price improvement.¹³⁹ Another commenter stated that, without knowledge of the order, it will be impossible for market makers to position themselves in advance in the appropriate pit, and therefore, multiple crowd areas will limit the ability of Floor Market Makers to participate, potentially threatening the best execution of customer orders.¹⁴⁰

In response to these concerns, BOX submitted Amendment No. 2 to provide that the Trading Floor will be comprised of a single Crowd Area.¹⁴¹ BOX further noted that all options classes will be located in that Crowd Area, and Floor Brokers must expose orders via open outcry in the Crowd Area.¹⁴²

¹³⁶ See CBOE Letter I and CTC Letter I, supra note 4.

¹³⁷ See CBOE Letter I, supra note 4, at 2, n.2.

¹³⁸ See CTC Letter I, supra note 4, at 6.

¹³⁹ See id.

¹⁴⁰ See Group One Letter, supra note 8, at 2.

¹⁴¹ See BOX Response Letter II, supra note 12, at 2.

¹⁴² See id.

The Commission believes that providing all Floor Market Makers the opportunity to respond to all orders on the Trading Floor is designed to increase the potential for competition for an order, which may increase the quality of order executions on BOX.¹⁴³

3. Market Makers Must Opt-In to Participate

Four commenters expressed concern about the aspect of the proposal that requires market makers to affirmatively opt-in to participate in a floor trade.¹⁴⁴ One commenter opposed the concept of assuming a market maker to be “out” by default and expressed their preference that BOX be required to allow Floor Market Makers to respond to a Floor Broker’s request for a quote before a cross is executed.¹⁴⁵ Another commenter stated its belief that the proposed default “out” is unnecessary so long as the proposed rules support ample opportunities for Floor Market Maker participation.¹⁴⁶ Another commenter requested clarification as to what would constitute participation for Floor Market Makers,¹⁴⁷ while a different commenter suggested that a Floor Market Maker’s failure to bid or offer in “immediate and rapid succession” could be treated the same way as the Floor Market Maker not responding at all—with the result that the Floor Market Maker will be considered “out” on the trade.¹⁴⁸

In response, BOX submitted Amendment No. 2 to provide that a Floor Broker will be required to give Floor Participants a reasonable amount of time to respond once the Floor Broker announces an order to the trading crowd.¹⁴⁹ BOX also clarified that after a Floor Broker

¹⁴³ See proposed BOX Rule 100(b)(5).

¹⁴⁴ See CTC Letter II, Group One Letter, Nasdaq Letter II, and NYSE Letter, supra note 8.

¹⁴⁵ See CTC Letter II, supra note 8, at 6.

¹⁴⁶ See Group One Letter, supra note 8, at 3.

¹⁴⁷ See Nasdaq Letter II, supra note 8, at 3.

¹⁴⁸ See NYSE Letter, supra note 8, at 2.

¹⁴⁹ See Notice of Amendment No. 2, supra note 11, at 23659. See also proposed BOX Rule

announces an order, a Floor Participant must verbalize that he is “in” even if the Floor Participant has already provided a valid quote prior to the announcement of the order by the Floor Broker.¹⁵⁰

The Commission believes the proposal should ensure that Floor Participants may respond to orders announced in the trading crowd. In addition, the Commission notes that Amendment No. 2 will require an Options Exchange Official to certify that a Floor Broker adequately announced a QOO Order to the trading crowd.¹⁵¹

4. Floor Market Maker Quoting Requirement

Five commenters expressed concern with the proposed requirement in BOX’s initial proposed rule change that Floor Market Makers would have to quote electronically in all classes offered on the proposed Trading Floor.¹⁵² One commenter stated that the imposition of an electronic quoting requirement could limit potential market maker price improvement.¹⁵³ This commenter further argued that the quoting requirement creates a barrier to entry that they believe will limit market-maker participation on the Trading Floor.¹⁵⁴ Another commenter suggested that the proposed requirement appears to impose a costly and unprofitable burden on would-be market makers, which will discourage them from participating on the Trading Floor and which in

100(b)(5).

¹⁵⁰ See Notice of Amendment No. 2, supra note 11, at 23660. In addition, the Exchange noted that at least one other options exchange with an options floor also requires members of its trading crowd to respond to participate in a floor crossing transaction. See CBOE Rule 6.74(a). See also NYSE Arca Rule 6.47(a); and NYSE American LLC Rule 934NY.

¹⁵¹ See proposed BOX Rule 7600(b).

¹⁵² See CBOE Letters I & II, CTC Letters I & II, Group One Letter, Nasdaq Letters I & II, and NYSE Letter, supra notes 4 and 8.

¹⁵³ See CBOE Letter I, supra note 4, at 2 n.2.

¹⁵⁴ See CBOE Letter II, supra note 8, at 2.

turn will create a trading floor which is devoid of opportunities for meaningful order exposure and price improvement.¹⁵⁵ This commenter further argued that the proposed rule change will discourage competitive market maker participation on the proposed Trading Floor.¹⁵⁶ In response to commenters' concerns, in Amendment No. 2, BOX eliminated the requirement to quote electronically in the classes that the Floor Market Maker quotes on the Trading Floor.¹⁵⁷

The Commission believes that BOX's proposal to require a Floor Market Maker to provide a two-sided market that complies with certain delineated quote spread parameters in response to any request for quote by a Floor Broker or Options Exchange Official, is consistent with the Act.

B. Single-Sided Floor Orders

Two commenters raised concerns about the inability of Floor Participants to represent single-sided orders on the proposed BOX Floor.¹⁵⁸ One commenter noted that some language in Amendment No. 1 "welcomes" Floor Brokers to bring unmatched orders to the Trading Floor, while other language stated that "orders on the floor must be two-sided orders," which the commenter found to be contradictory and confusing.¹⁵⁹ In response, the Exchange submitted Amendment No. 2 to specifically state that Floor Brokers will be permitted to bring an unmatched order to the Trading Floor in order to seek a contra-side, and then enter the order into the BOX system using the QOO order type.¹⁶⁰

¹⁵⁵ See CTC Letter I, supra note 4, at 5. See also CTC Letter III, supra note 13, at 2.

¹⁵⁶ See CTC Letter I, supra note 4, at 5.

¹⁵⁷ See Notice of Amendment No. 2, supra note 11, at 23658. See also BOX Response Letter II, supra note 12, at 2.

¹⁵⁸ See CBOE Letter I and CTC Letters I & II, supra notes 4 and 8.

¹⁵⁹ See CTC Letter II, supra note 8, at 8.

¹⁶⁰ See proposed BOX Rules 7580(e)(2), 7600(b), IM-7600-4. See also BOX Response

Specifically, the Exchange noted that, as was true in its initial proposed rule change, Floor Brokers will be permitted to bring single-sided orders to the Trading Floor in order to find contra-side liquidity.¹⁶¹ The Commission notes that the Exchange's proposed rules state that Floor Brokers will have the ability to represent single-sided orders on the Trading Floor, will be permitted to solicit bids and offers from Floor Market Makers to provide a contra-side order, and set forth rules governing the handling and execution of single-sided orders originating on the Trading Floor.

C. Trade-Through and Priority Rules

One commenter stated that the proposed rule change is unclear regarding how the proposed BOG would systematically prevent violations of priority and trade-through requirements.¹⁶² This commenter further stated that it is unclear whether exposure in the trading crowd is required and whether the market against which trades are validated differs depending on the method of execution.¹⁶³ Specifically, the commenter claimed that the proposed rule change does not sufficiently describe the timing and process for validating trades.¹⁶⁴ In addition, this commenter stated that the proposed rule change does not discuss the specific manner in which surveillance reviews transactions for violations of Exchange rules or the manner in which the BOG or the Exchange enforces compliance for on-floor transactions.¹⁶⁵

In response to the commenter's concern that the proposed rule change is unclear about whether the BOG would systematically prevent violations of priority and trade-through

Letter I, supra note 6, at 4.

¹⁶¹ See Notice of Amendment No. 2, supra note 11, at 23660.

¹⁶² See Nasdaq Letter I, supra note 4, at 2. See also Nasdaq Letter II, supra note 8, at 3-4.

¹⁶³ See Nasdaq Letter I, supra note 4, at 2.

¹⁶⁴ See id.

¹⁶⁵ See id. at 3.

requirements, BOX stated that the method by which trades are received and processed by the Trading Host serves as a safeguard to prevent violations of the priority and trade-through requirements.¹⁶⁶ BOX also noted that the execution does not occur when there is verbal agreement in the trading crowd, but rather when the executing Floor Broker sends the order from the Trading Floor to the Trading Host for execution.¹⁶⁷ BOX further stated that it structured the proposal to prevent trade-through violations and protect priority interest on the BOX Book.¹⁶⁸

In response to the commenter's suggestion that the proposed rule change does not adequately discuss surveillance, BOX stated that it currently has surveillance procedures in place to monitor compliance with the Exchange's rules and that these procedures will be used to monitor transactions originating from the Trading Floor.¹⁶⁹

In response to BOX's assurances regarding its proposed surveillance procedures, the commenter stated that it is unclear whether BOX would have real-time surveillance coverage on the trading floor in addition to other types of surveillance coverage.¹⁷⁰ The commenter suggested that real-time surveillance is necessary to monitor the unique aspects of member floor trading, such as negotiating open-outcry trades, handling floor disputes, and maintaining the ability to manually intervene in the floor environment.¹⁷¹

¹⁶⁶ See BOX Response Letter I, supra note 6, at 1-2. See also BOX Response Letter II, supra note 12, at 3 (stating that since the execution does not occur until the order is processed by the Trading Host, the system will enforce compliance with trade-through, priority, and other rules).

¹⁶⁷ See BOX Response Letter II, supra note 12, at 3.

¹⁶⁸ See BOX Response Letter I, supra note 6, at 2.

¹⁶⁹ See id.

¹⁷⁰ See Nasdaq Letter III, supra note 13, at 1-2.

¹⁷¹ See id.

In response, BOX stated that it will have both a real-time surveillance presence on the trading floor and other surveillance coverage.¹⁷² BOX further noted that proposed Rule 7600(b) will require an Options Exchange Official to certify that a Floor Broker adequately announced a QOO Order to the trading crowd and stated that such certification is only possible if the Official is physically present on the Trading Floor.¹⁷³ Finally, BOX reiterated that because all orders from the Trading Floor will be processed by the Trading Host, the Exchange also will electronically monitor all orders from the Trading Floor in the same manner as it does with electronic orders.¹⁷⁴

The Commission notes that the Exchange represents that the Trading Host will establish an electronic audit trail for options orders represented and executed by Floor Brokers, that according to the Exchange, will provide an accurate time-sequenced record of all orders from the Trading Floor, beginning with the receipt of an order by the Exchange and documenting all stages of the order.¹⁷⁵ The Commission believes that the proposed systematization of all orders submitted to the Trading Floor is designed to provide a more complete audit trail and allow the Exchange to better monitor compliance with applicable Commission regulations and Exchange Rules.¹⁷⁶ In addition, the Commission notes that the proposal requires all QOO Orders to be submitted through the BOG to be immediately processed by the Trading Host.¹⁷⁷ The Commission further notes that orders are not deemed executed until they are processed by the Trading Host. The Commission believes that the automation provided by the BOG and the

¹⁷² See BOX Response Letter III, supra note 14, at 2.

¹⁷³ See id.

¹⁷⁴ See id.

¹⁷⁵ See Notice of Amendment No. 2, supra note 11, at 23661.

¹⁷⁶ See proposed BOX Rule 7580(e)(1).

¹⁷⁷ See proposed BOX Rule 100(b)(2).

Trading Host may benefit the Exchange, its members and users, and other market participants by, for example, producing more accurate and timely trade reports and should ensure compliance with trade-through and priority rules. For example, the Trading Host will automatically prohibit a QOO Order from executing if such execution would trade-through a better priced order on the BOX Book (and the Floor Broker does not provide an adequate book sweep size) or on another market.¹⁷⁸ In addition, processing and executing all QOO Orders by the Trading Host could provide a more accurate timestamp for audit trail and recordkeeping purposes than a manual alternative.¹⁷⁹ The Commission believes that the functionality provided by the BOG and the Trading Host is reasonably designed to assist Floor Participants in complying with applicable Commission rules and regulations, and with the Exchange's Rules.

D. Book Sweep

Three commenters expressed concern about the proposed "book sweep size" mechanism.¹⁸⁰ One commenter suggested that the book sweep size would be a feature that prevents executions of orders on the BOX Book.¹⁸¹ The commenter further stated that the book sweep mechanism could prevent orders from executing in circumstances where there are orders on the BOX Book that could fill the order, possibly at a better price, and thus the mechanism potentially compromises its participants' compliance with best-execution obligations and unfairly discriminates against investors with executable orders resting in the BOX Book.¹⁸²

¹⁷⁸ See proposed BOX Rule 7600.

¹⁷⁹ The Commission notes that the proposed rule change does not permit trades to occur on the Trading Floor if there is a malfunction with the Trading Host or related Trading Floor systems such as the BOG. See proposed BOX Rule 7580(e)(1).

¹⁸⁰ See CBOE Letter II, CTC Letters I, II, & III, and NYSE Letter, supra notes 4, 8 and 13.

¹⁸¹ See CTC Letter I, supra note 4, at 7. See also CTC Letter III, note 13, at 3.

¹⁸² See CTC Letter I, supra note 4, at 7-8. See also CTC Letter III, note 13, at 3.

Another commenter suggested that the book sweep size functionality could allow Floor Brokers to ensure the internalization of orders by not designating a book sweep size.¹⁸³

In response to the commenters' concerns regarding the book sweep size aspect of the proposal, BOX stated that the book sweep size is a voluntary tool that will aid Floor Brokers in satisfying duties owed to their customers, such as best execution.¹⁸⁴ For example, according to BOX, when a Floor Broker needs an order to be executed immediately, the broker could opt either to provide a book sweep size equal to the entire size of the order, which provides liquidity to the BOX Book, or to provide an execution price that is better than the current best price on BOX, which presents an opportunity for potential price improvement.¹⁸⁵ BOX also noted that it believes functionality similar to the book sweep size mechanism is available on at least one other trading floor, so the book sweep size aspect of its proposal is not unique.¹⁸⁶ BOX further stated that any Floor Broker that uses the book sweep size for the purpose of violating his or her duties and obligations will be considered to have engaged in conduct inconsistent with just and equitable principles of trade.¹⁸⁷

The Commission believes that the book sweep size functionality should provide Floor Brokers with an efficient mechanism to automatically execute orders (provided they designate a sufficient book sweep size) without having to send a separate order to clear orders on the BOX Book that have priority.

¹⁸³ See CBOE Letter II, supra note 8, at 2.

¹⁸⁴ See BOX Response Letter I, supra note 6, at 3-4. See also BOX Response Letter II, supra note 12, at 3-4; BOX Response Letter III, supra note 14, at 3.

¹⁸⁵ See BOX Response Letter I, supra note 6, at 4.

¹⁸⁶ See id. See also BOX Response Letter II, supra note 12, at 4; BOX Response Letter III, supra note 14, at 3. BOX states that it believes the proposed book sweep size mechanism is comparable to the PHLX Floor Broker Management System.

¹⁸⁷ See BOX Response Letter II, supra note 8, at 4.

The Commission reminds broker-dealers that they have a legal duty to seek to obtain best execution of customer orders.¹⁸⁸ A broker-dealer’s duty of best execution derives from common law agency principles and fiduciary obligations, and is incorporated in SRO rules and, through judicial and Commission decisions, the antifraud provisions of the federal securities laws.¹⁸⁹ The duty of best execution requires broker-dealers to periodically assess the quality of competing markets to assure that order flow is directed to the markets providing the most beneficial terms for their customer orders.¹⁹⁰ Broker-dealers must examine their procedures for seeking to obtain

¹⁸⁸ See, e.g., Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 269-70, 274 (3d Cir.), cert. denied, 525 U.S. 811 (1998); Certain Market Making Activities on Nasdaq, Securities Exchange Act Release No. 40900 (Jan. 11, 1999) (settled case) (citing Sinclair v. SEC, 444 F.2d 399 (2d Cir. 1971); In re Arleen Hughes, 27 SEC 629, 636 (1948), aff’d sub nom. Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949)). See also Order Execution Obligations, Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290 (Sept. 12, 1996) (“Order Handling Rules Release”).

¹⁸⁹ Order Handling Rules Release, supra note 188, at 48322. See also Newton, 135 F.3d at 270. Failure to satisfy the duty of best execution can constitute fraud because a broker-dealer, in agreeing to execute a customer’s order, makes an implied representation that it will execute it in a manner that maximizes the customer’s economic gain in the transaction. See Newton, 135 F.3d at 273 (“[T]he basis for the duty of best execution is the mutual understanding that the client is engaging in the trade – and retaining the services of the broker as his agent – solely for the purpose of maximizing his own economic benefit, and that the broker receives her compensation because she assists the client in reaching that goal.”); In re Marc N. Geman, Securities Exchange Act Release No. 43963 (Feb. 14, 2001) (citing Newton, but concluding that respondent fulfilled his duty of best execution). See also Payment for Order Flow, Securities Exchange Act Release No. 34902 (Oct. 27, 1994), 59 FR 55006, 55009 (Nov. 2, 1994) (“Payment for Order Flow Final Rules”). If the broker-dealer intends not to act in a manner that maximizes the customer’s benefit when he accepts the order and does not disclose this to the customer, the broker-dealer’s implied representation is false. See Newton, 135 F.3d at 273-274.

¹⁹⁰ Order Handling Rules Release, supra note 188, at 48322-33 (“In conducting the requisite evaluation of its internal order handling procedures, a broker-dealer must regularly and rigorously examine execution quality likely to be obtained from different markets or market makers trading a security.”). See also Newton, 135 F.3d at 271; Market 2000: An Examination of Current Equity Market Developments, at V-4 (SEC Division of Market Regulation January 1994) (“Without specific instructions from a customer, however, a broker-dealer should periodically assess the quality of competing markets to ensure that

best execution in light of market and technology changes and modify those practices if necessary to enable their customers to obtain the best reasonably available prices.¹⁹¹ In doing so, broker-dealers must take into account price improvement opportunities, and whether different markets may be more suitable for different types of orders or particular securities.¹⁹²

E. Compliance with Section 11(a) of the Act

One commenter expressed concern that BOX may not have adequately explained how options participants would comply with Section 11(a)(1) of the Act when effecting transactions through the BOG.¹⁹³ More specifically, this commenter noted that BOX did not explain how a BOX member that is the counterparty to a QOO Order would comply with Section 11(a) of the Act.¹⁹⁴ In response, BOX amended its proposal to help ensure compliance with Section 11(a)(1) of the Act.¹⁹⁵

Section 11(a)(1) of the Act¹⁹⁶ 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 investment discretion (collectively, “covered accounts”), unless an exception applies. Sections 11(a)(1)(A)-(I) of the Act¹⁹⁷ and the rules thereunder provide certain exemptions from this general prohibition, including the

its order flow is directed to markets providing the most advantageous terms for the customer’s order.”); Payment for Order Flow Final Rules, supra note 189, at 55009.

¹⁹¹ Order Handling Rules, supra note 188 at 48323.

¹⁹² See id.

¹⁹³ See NYSE Letter, supra note 8, at 5-6.

¹⁹⁴ See id.

¹⁹⁵ See BOX Response Letter II, supra note 12, at 4.

¹⁹⁶ 15 U.S.C. 78k(a)(1).

¹⁹⁷ 15 U.S.C. 78k(a)(1)(A)-(I).

exemption set forth in Rule 11a2-2(T) under the Act.¹⁹⁸ The Exchange represents that its proposed rule change is consistent with Section 11(a) of the Act and the rules thereunder.¹⁹⁹ The Exchange also states that the proposed rule change would not limit in any way the obligation of a Participant to comply with Section 11(a) of the Act or the rules thereunder.²⁰⁰

The Commission notes that the Exchange proposes to adopt IM-7600-5, which states that a Participant shall not utilize the Trading Floor to effect any transaction for a covered account by relying on an exemption under Section 11(a)(1)(G) of the Act (“G Exemption”).²⁰¹ As the Exchange notes, because no covered account transactions utilizing the Trading Floor may rely on the G Exemption, Participants utilizing the Trading Floor to effect transactions for covered accounts may only rely upon other exemptions to the Section 11(a)(1) prohibition.²⁰²

¹⁹⁸ 17 CFR 240.11a2-2(T).

¹⁹⁹ See Notice of Amendment No. 2, supra note 11, at 23681.

²⁰⁰ See id.

²⁰¹ 15 U.S.C. 78k(a)(1)(G). Section 11(a)(1)(G) of the Act provides an exemption from the general prohibition in Section 11(a)(1) of the Act for any transaction for a member’s own account, provided that: (i) such member 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; and (ii) such transaction is effected in compliance with rules of the Commission which, as a minimum, assure that the transaction is not inconsistent with the maintenance of fair and orderly markets and yields priority, parity, and precedence in execution to orders for the account of persons who are not members or associated with members of the exchange. See also 17 CFR 240.11a1-1(T) (setting forth requirements for relying on the G Exemption).

²⁰² See Notice of Amendment No. 2, supra note 11, at 23681. Section 11(a) of the Act and the rules thereunder provide other exemptions to the Section 11(a)(1) prohibition, including, for example, the “effect versus execute” exemption (as discussed below), the exemption for transactions by a dealer acting in the capacity of a market maker, and the exemption for transactions to offset a transaction made in error.

In addition to statutory exemptions, Rule 11a2-2(T) under the Act,²⁰³ 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 the order has been transmitted to the member performing the execution;²⁰⁴ (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member or an associated person has investment discretion, neither the member nor an 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 Participants utilizing the Trading Floor may comply with the conditions of Rule 11a2-2(T) under the Act.²⁰⁵

Rule 11a2-2(T)’s first requirement is that orders for covered accounts be transmitted from off the exchange floor. The Commission has found that the off-floor transmission requirement is

²⁰³ 17 CFR 240.11a2-2(T).

²⁰⁴ This prohibition also applies to associated persons of the initiating member. The member may, however, participate in clearing and settling the transaction.

²⁰⁵ The Commission has previously found that the all-electronic transactions effected through the Trading Host are consistent with the requirements of Section 11(a) of the Act and Rule 11a2-2(T) thereunder. See, e.g., Securities Exchange Act Release Nos. 72848 (August 14, 2014), 79 FR 49361 (August 20, 2014) (SR-BOX-2014-16) (order approving the Exchange’s proposal to adopt new trade allocation algorithms for matching trades at the conclusion of the PIP and the COPIP); and 66871 (April 27, 2012), 77 FR 26323 (May 3, 2012) (order granting the Exchange’s application for registration as a national securities exchange). As part of the current proposal, the Exchange represents that the Trading Host will enforce trade-through and priority rules in the same manner for QOO orders as the Trading Host does for all other orders on the Exchange. See Notice of Amendment No. 2, supra note 11, at 23659.

met if a covered account order is transmitted from a remote location directly to an exchange's floor by electronic means.²⁰⁶ The Exchange states that Floor Brokers will receive matched or unmatched orders either via telephone, or electronically to the Floor Broker's order entry mechanism.²⁰⁷ Moreover, the Exchange states that a Participant could submit an order for a covered account from off the Trading Floor to an unaffiliated Floor Broker for representation on the Trading Floor and use the "effect versus execute" exemption (assuming the other conditions of the rule are satisfied).²⁰⁸ The Commission notes that a Participant that submits an order for a covered account that utilizes the Trading Floor, and who wishes to rely on the "effect versus execute" exemption, must submit the order from off the Trading Floor.

Second, Rule 11a2-2(T) requires that neither the initiating member nor an associated person of the initiating member participate in the execution of the transaction at any time after the order for the transaction has been transmitted. The Exchange represents that at no time following the submission of an order utilizing the Trading Floor will the submitting Participant or any associated person of such Participant acquire control or influence over the result or timing of the order's execution.²⁰⁹ In addition, the Exchange states that once a Floor Broker submits a QOO

²⁰⁶ See, e.g., Securities Exchange Act Release Nos. 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979); and 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) ("1978 Release").

²⁰⁷ See Notice of Amendment No. 2, supra note 11, at 23666.

²⁰⁸ See id. at 23681.

²⁰⁹ See id. The Commission notes that a Participant may cancel or modify the order, or modify the instructions for executing the order. The Commission has stated that the non-participation requirement is satisfied under such circumstances so long as the modifications or cancellations are also transmitted from off the floor. See 1978 Release, supra note 206, at 11547 (stating that the "non-participation requirement does not prevent initiating members from canceling or modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor").

order to the BOG for execution, neither the Floor Broker nor anyone else may alter the terms of the order.²¹⁰ Moreover, when a Floor Broker submits a QOO Order for execution, the order will be executed in accordance with Exchange rules and based on market conditions of when the order is received by the Trading Host.²¹¹ Accordingly, based on the Exchange's representations, the Commission believes that a Participant and its associated persons would not participate in the execution of an order submitted for execution utilizing the Trading Floor.

Third, Rule 11a2-2(T) requires that the order be executed by an exchange member that is not associated with the member initiating the order. According to the Exchange, to rely on the exemption in Rule 11a2-2(T), a Participant could submit an order for a covered account from off the Trading Floor to an unaffiliated Floor Broker.²¹² The Exchange also states that a Participant relying on Rule 11a2-2(T) could not submit an order for a covered account to its "house" Floor Broker on the Trading Floor for execution.²¹³ The Commission notes that if a Participant sends its order from off the floor to an affiliated Participant that is on the floor, who then directs the order into the Trading Host for execution, the off-floor Participant may not rely on the exemption in Rule 11a2-2(T).

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 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

²¹⁰ See proposed Rule 7600(c) and Notice of Amendment No. 2, supra note 11, at 23666.

²¹¹ See proposed Rule 7600(a) and Notice of Amendment No. 2, supra note 11, at 23665.

²¹² See Notice of Amendment No. 2, supra note 11, at 23681.

²¹³ See id.

11a2-2(T) thereunder.²¹⁴ The Commission notes that Participants and their associated persons trading for covered accounts over which they exercise investment discretion must comply with this condition in order to rely on the rule's exemption.

F. Options Market Structure: Price Improvement, Fragmentation and Trading Floor Data

Three commenters expressed concern that the proposed rule change would negatively impact opportunities for orders to receive price improvement.²¹⁵ Specifically, one commenter stated that the proposed rule change is designed to minimize opportunities for market maker and public customer trading interest to interact with, and provide price improvement to, orders being crossed on the BOX floor.²¹⁶ This commenter asserts that the proposed rule change is designed to offer a frictionless crossing mechanism, which can be utilized to the detriment of customers.²¹⁷

Two commenters expressed concern that the proposed rule change would increase fragmentation in the options trading market. One commenter stated that the proposed BOX floor would add an additional trading venue that firms, who have finite resources, would be required to staff and which would further fragment liquidity without offering anything unique or

²¹⁴ In addition, Rule 11a2-2(T)(d) requires that, if a member or associated person is authorized by written contract to retain compensation in connection with effecting transactions for covered accounts over which the member or associated person thereof exercises investment discretion, the member or associated person must 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 or any associated person thereof in connection with effecting transactions for the account during the period covered by the statement. See 17 CFR 240.11a2-2(T)(d). See also 1978 Release, supra note 206, at 11548 (stating that “[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests”).

²¹⁵ See CBOE Letters I & II, CTC Letters I & II, and Nasdaq Letter II, supra notes 4, 8 and 13.

²¹⁶ See CBOE Letter I, supra note 4, at 1-2.

²¹⁷ See id. at 2.

beneficial to customers.²¹⁸ Another commenter stated that opening a new trading floor will exacerbate the practice of “venue shopping,” and noted that the number of market making firms is limited, and that market making firms lack the resources necessary to staff an escalating number of physical trading floors with dedicated personnel.²¹⁹

In response, BOX argues that concerns about the general success of options trading floors are beyond the scope of its proposal.²²⁰ BOX further asserts that raising concerns about options trading floors either lacks merit or is an attempt to delay the approval of its proposal.²²¹ In addition, BOX commits to provide the Commission with data related to activity on the Trading Floor, specifically information regarding size, participation, price improvement by spread and trade type, effective spread, Floor Market Maker participation, and BOX Book participation.²²² This information could be used to evaluate, among other things, the levels of participation and amount of price improvement on the Trading Floor. Finally, BOX indicated that it believes a new trading floor will be good for the markets by providing increased competition which may lead to improvements in the market, which will inure to the benefit of all market participants.²²³

The Commission believes that the proposed rule change is consistent with the Act. Under the proposed rule change, the Exchange will establish an “open outcry” trading floor where orders will be sent to Floor Brokers who will represent those orders in an agency capacity, and who will be required to announce such orders to a trading crowd composed of Floor Market Makers prior to any execution. In this regard, the Commission notes that the Exchange made

²¹⁸ See CBOE Response Letter I, supra note 4, at 1.

²¹⁹ See CTC Letter I, supra note 4, at 3.

²²⁰ See BOX Response Letter I, supra note 6, at 4.

²²¹ See id.

²²² See Notice of Amendment No. 2, supra note 11, at 23679.

²²³ See BOX Response Letter III, supra note 14, at 3-4.

modifications to the initial proposal that are designed to remove or reduce the potential impediments to order interaction on the BOX Floor and which are designed to increase opportunities for price improvement. The Commission also notes that the data the Exchange has committed to provide may assist the Commission in assessing the level of participation in crossing transactions by market makers and other market participants, aside from the firm that initiated the cross, and to better review whether existing exchange rules appropriately allow for robust and beneficial competition on the options trading floors.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²²⁴ that the proposed rule change (SR-BOX-2016-48), as modified by Amendment Nos. 1 and 2, be, hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²⁵

Eduardo A. Aleman
Assistant Secretary

²²⁴ 15 U.S.C. 78s(b)(2).

²²⁵ 17 CFR 200.30-3(a)(12).