

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87375; File No. SR-BOX-2019-31)

October 21, 2019

Self-Regulatory Organizations; BOX Exchange LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend Exchange Rule IM-7170-1, to Make Permanent the Exchange Rule that is Linked to the Equity Market Plan to Address Extraordinary Market Volatility

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 18, 2019, BOX Exchange LLC (the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

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

The Exchange proposes to amend Exchange Rule IM-7170-1, to make permanent the Exchange Rule that is linked to the equity market Plan to Address Extraordinary Market Volatility (the “Limit Up-Limit Down Plan” or the “Plan”). The text of the proposed rule change is available from the principal office of the Exchange, at the Commission’s Public Reference Room and also on the Exchange’s Internet website at <http://boxoptions.com>.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend BOX Rule IM-7170-1 to make permanent the Exchange Rule that is connected to the Plan. This change is being proposed in connection with the recently approved amendment to the Limit Up-Limit Down Plan that allows the Plan to continue to operate on a permanent basis (“Amendment 18”).³

In an attempt to address extraordinary market volatility in NMS stocks, and, in particular, events like the severe volatility on May 6, 2010, U.S. national securities exchanges and the Financial Industry Regulatory Authority, Inc. (collectively, “Participants”) drafted the Plan pursuant to Rule 608 of Regulation NMS under the Act.⁴ On May 31, 2012, the Commission approved the Plan, as amended, on a one-year pilot basis.⁵ Though the Plan was primarily designed for equity markets, the Exchange believed it would, indirectly, potentially impact the options markets as well. Thus, the Exchange has previously adopted and amended Rule IM-7170-1 to ensure the option markets were not harmed as a result of the Plan’s implementation and implemented the rule on a pilot basis that has coincided with the pilot period for the Plan (“Options Pilot”).⁶

³ See Securities Exchange Act Release No. 85623 (April 11, 2019), 84 FR 16086 (April 17, 2019) (Order Approving Amendment No. 18).

⁴ See Securities Exchange Act Release No. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011) (File No. 4-631).

⁵ See Securities and Exchange Act Release No. 67091 (May 31, 2012) 77 FR 33498 (June 6, 2012).

⁶ See Securities Exchange Act Release Nos. 34-76233 (October 22, 2015), 80 FR 66087

Rule IM-7170-1 provides that transactions executed during a limit or straddle state are not subject to the obvious and catastrophic error rules. A limit or straddle state occurs when at least one side of the National Best Bid (“NBB”) or Offer (“NBO”) bid/ask is priced at a non-tradable level. Specifically, a straddle state exists when the NBB is below the lower price band while the NBO is inside the price band or when the NBO is above the upper price band and the NBB is within the band, while a limit state occurs when the NBO equals the lower price band (without crossing the NBB), or the NBB equals the upper price band (without crossing the NBO). The Exchange adopted the Options Pilot to protect investors because when an underlying security is in a limit or straddle state, there will not be a reliable price for the security to serve as a benchmark for the price of the option. Specifically, the Exchange adopted Rule IM-7170-1 because the application of the obvious and catastrophic error rules would be impracticable given the potential for lack of a reliable NBBO in the options market during limit and straddle states. When adjusting or busting a trade pursuant to the obvious error rule, the determination of theoretical value of a trade generally references the NBB (for erroneous sell transactions) or NBO (for erroneous buy transactions) just prior to the trade in question, and is therefore not reliable when at least one side of the NBBO is priced at a non-tradeable level, as is the case in limit and straddle states. In such a situation, determining theoretical value may often times be a very subjective rather than an objective determination and could give rise to additional uncertainty and confusion for investors. As a result, application of the obvious and catastrophic error rules would be impracticable given the lack of a reliable NBBO in the options market during limit and straddle states, and may produce undesirable effects or unanticipated consequences. The Exchange adopted IM-7170-1 as an

(October 28, 2015) (SR-BOX-2015-34) (proposing to extend pilot program to coincide with the pilot period for the Plan).

additional measure designed to protect investors during limit and straddle states. For example, the Exchange believes that eliminating the application of obvious error rules during a limit or straddle state eliminates the re-evaluation of a transaction executed during such a state that could potentially create an unreasonable adverse selection opportunity due to lack of a reliable reference price on one side of the market or another and discourage participants from providing liquidity during limit and straddle states, which is contrary to the goal in limiting participants' adverse selection with the application of the obvious error rule during normal trading states. The Exchange believes the Options Pilot is designed to add certainty on the options markets, which encourages more investors to participate in light of the changes associated with the Plan. The Plan was originally implemented on a pilot-basis in order to allow the public, the participating exchanges, and the Commission to assess the operation of the Plan and whether the Plan should be modified prior to approval on a permanent basis. As stated, the Exchange adopted the Option Pilot to coincide with this pilot; to continue the protections therein while the industry gains further experience operating the Plan.

In connection with the order approving the establishment of the obvious error pilot, as well as the extensions of the obvious error pilot, the Exchange committed to submit monthly data regarding the program and to submit an overall analysis of the obvious error pilot in conjunction with the data submitted under the Plan and any other data as requested by the Commission. Pursuant to a rule filing, approved on May 8, 2015, each month, the Exchange committed to provide the Commission, and the public, a dataset containing the data for each straddle and limit state in optionable stocks that had at least one trade on the Exchange.⁷ The

⁷ See Securities Exchange Act Release No. 34-74911 (May 8, 2015), 80 FR 27717 (May 14, 2015) (SR-BOX-2015-18); see also BOX Limit Up Limit Down Reports <https://boxoptions.com/regulatory/governing-documents-related-information-nms->

Exchange has continued to provide the Commission with this data on a monthly basis from May 2015. For each trade on the Exchange, the Exchange provides (a) the stock symbol, option symbol, time at the start of the straddle or limit state, an indicator for whether it is a straddle or limit state, and (b) for the trades on the Exchange, the executed volume, time-weighted quoted bid-ask spread, time-weighted average quoted depth at the bid, time-weighted average quoted depth at the offer, high execution price, low execution price, number of trades for which a request for review for error was received during straddle and limit states, an indicator variable for whether those options outlined above have a price change exceeding 30% during the underlying stock's limit or straddle state compared to the last available option price as reported by OPRA before the start of the limit or straddle state. In addition, to help evaluate the impact of the pilot program, the Exchange has provided to the Commission assessments evaluating the options market quality during Limit and Straddle States, the character of incoming order flow and transactions during Limit and Straddle States, and reviews of any complaints from members and their customers concerning executions during Limit and Straddle States. The Exchange has concluded that the obvious error pilot does not negatively impact market quality during normal market conditions, and that there has been insufficient data to assess whether a lack of obvious error rules is problematic, however, the Exchange believes the continuation of Rule IM-7170-1 functions to protect against any unanticipated consequences in the options markets during a limit or straddle state and add certainty on the options markets.

The Commission recently approved the Plan on a permanent basis (Amendment 18).⁸ In connection with this approval, the Exchange now proposes to amend the Exchange Rule IM-7170-1 that currently implement the provisions of the Plan on a pilot basis to eliminate the pilot basis, which effectiveness expires on October 18, 2019, and to make such rules permanent. In its approval order to make the Plan permanent, the Commission recognized that, as a result of the Participants' and industry analysis of the Plan's operation, the Limit Up-Limit Down mechanism effectively addresses extraordinary market volatility. Indeed, the Plan benefits markets and market participants by helping to ensure orderly markets, but also, the Exchange believes, based on the data made available to the public and the Commission during the pilot period, that the obvious error pilot does not negatively impact market quality during normal market conditions. Rather, the Exchange believes the obvious error pilot functions to protect against any unanticipated consequences in the options markets during a limit or straddle state and add certainty on the options markets. This removes impediments to and perfects the mechanism of a free and open market and national market system by encouraging more investors to participate in light of the changes associated with the Plan. The Exchange believes that if approved on a permanent basis, the Options Pilot would permanently provide investors with the above-described additional certainty of market prices and mitigation of unanticipated consequences and unreasonable adverse selection risk during limit and straddle states.

The Exchange understands that the other national securities exchanges will also file similar proposals to make permanent their respective pilot programs. Since the Commission's approval of Amendment 18 allowing the Plan to operate on a permanent basis, the Exchange

⁸ See supra note 3.

and other national securities exchanges have determined that no further amendments should be made to the Options Pilot; the current Option Pilot effectively addresses extraordinary market volatility, is reasonably designed to comply with the requirements of the Plan, facilitates compliance with the Plan and should now operate on a permanent basis, consistent with the Plan. The Exchange does not propose any substantive or additional changes to Exchange Rule IM-7170-1.

2. Statutory Basis

The Exchange believes that the proposal is consistent with the requirements of Section 6(b) of the Securities Exchange Act of 1934 (the “Act”),⁹ in general, and Section 6(b)(5) of the Act,¹⁰ in particular, in that it is 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 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. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹¹ requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, The Exchange believes that the proposed rule supports the objectives of perfecting the mechanism of a free and open market and the national market system because it promotes transparency and uniformity across markets concerning rules for options markets adopted to coincide with the Plan. The Exchange believes that eliminating the pilot basis for

⁹ 15 U.S.C. 78f(b).

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ Id.

the Options Pilot and making the rule permanent facilitates compliance with the Plan by adding certainty to the markets during periods of market volatility, which has been approved and found by the Commission to be reasonably designed to prevent potentially harmful price volatility in NMS Stocks. It has been determined by the Commission that the Plan benefits markets and market participants by helping to ensure orderly markets, and, based on the data made available to the public and the Commission during the pilot period for Rule IM-7170-1, the Plan does not negatively impact options market quality during normal market conditions. Rather, the Plan, as it is implemented under the obvious error pilot, functions to protect against any unanticipated consequences in the options markets during a limit or straddle state and adds certainty on the options markets. During a limit or straddle state, determining theoretical value of an option may be a subjective rather than an objective determination given the lack of a reliable NBBO, which may create an unreasonable adverse selection opportunity and discourage participants from providing liquidity during limit and straddle states. Therefore, the Exchange believes eliminating obvious error review in such states would, in turn, eliminate uncertainty and confusion for investors and benefit investors by encouraging more participation in light of the changes associated with the Plan.

Accordingly, the Exchange believes that making the Options Pilot permanent will further the goals of investor protection and fair and orderly markets as the rule effectively addresses extraordinary market volatility pursuant to the Plan.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In this regard and as indicated above, this change is being proposed in connection with the recently approved amendment to the Limit Up-Limit Down Plan that allows the Plan to continue to operate on a

permanent basis.¹² The proposed rule change is necessary to reflect that the Plan no longer operates as a pilot and has been approved to operate on a permanent basis by the Commission. As such, Exchange Rule IM-7170-1, which implements protections in connection with the Plan, should be amended to operate on a permanent basis. The Exchange understands that the other national securities exchanges will also file similar proposals to make permanent their respective pilot programs. Thus, the proposed rule change will help to ensure consistency across market centers without implicating any competitive issues.

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

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

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act¹³ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁴

A proposed rule change filed under Rule 19b-4(f)(6)¹⁵ normally does not become operative prior to 30 days after the date of the filing. However, Rule 19b-4(f)(6)(iii)¹⁶ permits

¹² See *supra*, note 3.

¹³ 15 U.S.C. 78s(b)(3)(A)(iii).

¹⁴ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

¹⁵ 17 CFR 240.19b-4(f)(6).

¹⁶ 17 CFR 240.19b-4(f)(6)(iii).

the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposed rule change may become effective and operative immediately upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest, as it will allow the current Options Pilots to continue on a permanent basis without any changes, prior to the pilot expiration on October 18, 2019. For this reason, the Commission hereby waives the 30-day operative delay and designates the proposed rule change as operative upon filing.¹⁷

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
- or

¹⁷ For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-BOX-2019-31 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-BOX-2019-31. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BOX-2019-31 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Eduardo A. Aleman
Deputy Secretary

¹⁸ 17 CFR 200.30-3(a)(12).