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SECURITIES AND EXCHANGE COMMISSION  
[Release No. 34-83525; File No. SR-BOX-2018-20]

Self-Regulatory Organizations; BOX Options Exchange LLC; Notice of Filing of Proposed Rule Change to Amend BOX Rule 7300 (Preferred Orders) to Provide an Additional Allocation Preference to Preferred Market Makers

June 26, 2018

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 13, 2018, BOX Options 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 change from interested persons.

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

The Exchange proposes to amend BOX Rule 7300 (Preferred Orders) to provide an additional allocation preference to Preferred Market Makers. 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

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

places 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 7300 (Preferred Orders) to provide an additional allocation preference to Preferred Market Makers. Specifically, the Exchange is proposing to provide Preferred Market Makers with a small size order allocation preference.

**Background**

The Exchange has rules to allow BOX Options Participants (“Participants”) to submit orders for which a Market Maker is designated to receive an allocation preference on the Exchange (“Preferred Orders”).<sup>3</sup> The rules provide for the enhanced allocation to the Preferred Market Maker<sup>4</sup> only when the Preferred Market Maker is quoting at NBBO.

A Preferred Order is any order submitted by a Participant to the Exchange for which a Preferred Market Maker is designated to receive execution priority, with respect to a portion of the Preferred Order, upon meeting certain qualifications.<sup>5</sup> Preferred Orders are submitted by a Participant by designating an order as such and identifying a Preferred Market Maker when entering the order.

In order for a Preferred Market Maker to be eligible to receive Preferred Orders, they must maintain heightened quoting activity. Specifically, a Preferred Market Maker must

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<sup>3</sup> See Rule 7300.

<sup>4</sup> The term “Preferred Market Maker” means a Market Maker designated as such by a Participant with respect to an order submitted by such Participant to BOX. See Rule 7300(a)(2).

<sup>5</sup> See Rule 7300.

maintain a continuous two-sided market, throughout the trading day, in 99% of the non-adjusted option series of each class for which it accepts Preferred Orders, for 90% of the time the Exchange is open for trading in each such option class.<sup>6</sup> A Preferred Market Maker is not required to quote in intra-day add-on series or series that have a time to expiration of nine months or more in the classes for which it receives Preferred Orders.

### **Small Size Orders**

The Exchange is now proposing to amend Rule 7300 to provide an additional allocation preference to Preferred Market Makers. Specifically, the Exchange is proposing that small size Preferred Orders will be allocated in full to the Preferred Market Maker, subject to certain conditions described below.<sup>7</sup> Small size orders are defined as five (5) or fewer contracts.

In order for the Preferred Market Makers to be allocated the small size order, they must be quoting at the NBBO when they receive the Preferred Order. As is the case with the current allocation of Preferred Orders, all orders from the account of Public Customers, if any, will continue to be allocated for execution against the Preferred Order first. The Preferred Market Maker will only receive the small size order allocation if there are contracts remaining after any Public Customer orders receive an allocation against the Preferred Order. A Preferred Market Maker may only be allocated up to the size of their quote.

The Exchange will monitor the frequency in which Preferred Market Makers receive the small size order allocation. Specifically, the Exchange will review the proposed provision quarterly and will maintain the small order size at a level that will not allow small size orders executed by Preferred Market Makers to account for more than 40% of the volume executed on the Exchange.

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<sup>6</sup> See Rule 7300(a)(2).

<sup>7</sup> See proposed Rule 7300(e).

The Exchange does not believe the proposal raises any new or novel issues. Currently, the vast majority of options exchanges provide a small lot allocation preference to specialists,<sup>8</sup> with the majority of those exchanges restricting the number of specialists to one per class. The Exchange's proposal differs in that the Exchange is expanding the availability of the small lot allocation preference to all eligible Preferred Market Makers. The Exchange believes that providing this benefit to multiple Preferred Market Makers will be beneficial to the Exchange and the market by providing an incentive for vigorous quoting by multiple market makers per class since a Preferred Market Maker must be quoting at NBBO in order to receive the small lot allocation preference. Additionally, as explained above, Preferred Market Makers are responsible for heightened quoting obligations that must be met in order for them to receive Preferred Orders.

Further, the numerous options exchanges that provide exclusive specialist assignments afford the opportunity for a market maker to be the sole specialist in different classes on multiple exchanges. This can, and most likely does, result in a market maker having an exclusive specialist assignment in nearly every option class spread across multiple exchanges. Therefore, they are entitled to a small lot allocation preference in every option class. As a result of this, an

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<sup>8</sup> Cboe EDGX Rule 21.8(g)(2) provides a small lot allocation preference to Primary Market Makers, Nasdaq ISE Rule 713.01(c) provides a small lot allocation preference for Primary Market Makers, NYSE American Rule 964.2NY provides a small lot allocation preference to the Primary Specialist, Nasdaq BX Chap. VI, Section 10(c)(2) provides a small lot allocation preference for the Lead Market Maker, Nasdaq GEM [sic] Rule 713.01(c) provides a small lot allocation preference for Primary Market Makers, Nasdaq MRX provides a small lot allocation preference for Primary Market Makers, Nasdaq PHLX Rule 1014(g)(vii)(B)(1)(a) provides a small lot allocation preference to specialist, MIAX Rule 514(g)(2) provides a small lot allocation preference for the Primary Lead Market Maker, NYSE Arca Rule 6.76A-O(a)(1)(B) provides a small lot allocation preference for the Lead Market Maker, and Cboe Rule 6.45(c) provides a small lot allocation preference for the Designated Primary Market Makers or the Lead Market Maker.

order flow provider can direct small lot orders to a specific specialist by submitting the order to the exchange where the specialist is exclusive for that specific class and the specialist would have priority over all orders and quotes except those of Public Customers to trade against the small lot. The Exchange does not believe that providing the small lot allocation preference to all qualified Preferred Market Makers will alter this current behavior because, under the proposal, an order flow provider can achieve the same result by preferencing the order on BOX to a specific Preferred Market Maker.

In addition, the Exchange notes that it has increased quoting requirements for market makers to be eligible to receive the small lot allocation preference. Specifically, a Preferred Market Maker must maintain a continuous two-sided market, pursuant to Rule 8050(c)(1), throughout the trading day, in 99% of the non-adjusted option series of each class for which it accepts Preferred Orders, for 90% of the time the Exchange is open for trading in each such option class.<sup>9</sup> The Exchange notes that these quoting requirements are higher than another exchange that currently provides a small-lot allocation preference.<sup>10</sup>

### **Allocation**

Currently, the Exchange's Rules provide that at the final price level, where the remaining quantity of the Preferred Order is less than the total quantity of orders on the Exchange available for execution, after all orders for the account of Public Customers, if any, are allocated against the Preferred Order, then the Preferred Market Maker receives its allocation.<sup>11</sup>

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<sup>9</sup> For purposes of this requirement, a Preferred Market Maker is not required to quote in intra-day add-on series or series that have a time to expiration of nine months or more in the classes for which it receives Preferred Orders and a Market Maker may still be a Preferred Market Maker in any such series if the Market Maker otherwise complies with Rule 7300(a)(2).

<sup>10</sup> See Cboe EDGX Rule 22.6(d).

<sup>11</sup> See Rule 7300(c)(2).

Specifically, a Preferred Market Maker shall receive an allocation equal to forty percent (40%) of the remaining quantity of the Preferred Order. However, if only one other executable, non-public Customer order (in addition to the quote of the Preferred Market Maker) matches the Preferred Order at the final price level, then the allocation to the Preferred Market Maker shall be equal to fifty percent (50%) of the remaining quantity of the Preferred Order.

The Exchange is now proposing to amend the Preferred Market Maker allocation when there is only one other non-Public Customer that matches the Preferred Order at the final price level. Specifically, the Exchange is proposing to increase the Preferred Market Maker's allocation to 60% when there is only one other non-Public Customer that matches the Preferred Order at the final price level. The Exchange notes that other exchanges currently provide a 60% allocation when there is only one other Participant that matches the Preferred Order at the final price level.<sup>12</sup>

The quantity of the allocation to the Preferred Market Maker will continue to be limited by the total quantity of the Preferred Market Maker quote. Executions are allocated in numbers of whole contracts and, to ensure the allocation priority afforded to Preferred Market Makers does not exceed the applicable 40% or proposed 60%, allocations of fractional contracts to Preferred Market Makers in the Preferred allocation step are rounded down to the nearest whole number, which is not less than one (1) contract. Legging Orders will not be considered when determining whether the Preferred Market Maker is allocated 40% or the proposed 60% in this step. As a result, in no case will a Preferred Market Maker receive an allocation preference (above what it would otherwise receive if executed in normal price-time priority) in excess of

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<sup>12</sup> See MIAX Rule 514(g); see also ISE Supplementary Material .03 to Rule 713.

40% of the remaining quantity of the Preferred Order after Public Customer orders are filled (or the proposed 60% if only one other non-Public Customer matches) at the final price level.

## 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”),<sup>13</sup> in general, and Section 6(b)(5) of the Act,<sup>14</sup> 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.

In particular, the Exchange believes this proposed rule change is a reasonable modification designed to provide incentives and enhanced allocation to Preferred Market Makers when it is quoting at NBBO. The Exchange also believes that the proposed rule change will increase the number of transactions on the Exchange by attracting additional order flow to the Exchange, which will ultimately enhance competition and provide customers with additional opportunities for execution. The Exchange believes these changes are consistent with the goals to remove impediments to and to perfect the mechanism for a free and open market and a national market system. Specifically, the Exchange believes that the proposal will result in increased liquidity available at improved prices, with more competitive pricing outside the control of any single Participant. The proposed rule change should promote and foster competition.

The Exchange believes the proposed changes to the Preferred Order allocation to provide a small lot allocation preference is an improvement over the current allocation algorithm,

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<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

and will benefit all market participants submitting Preferred Orders on the Exchange. As a result of the proposed changes, the Exchange believes that existing and additional Participants will use Preferred Orders to increase the number of orders that are submitted to the Exchange. Additionally, the Exchange believes that the proposed change to the Preferred Order allocation algorithm will encourage greater participation by Market Makers to provide quotes on the Exchange as Preferred Market Makers. These additional responses should encourage greater competition on the Exchange, which should, in turn, benefit and protect investors and the public interest through the potential for greater volume of orders and executions.

The proposed rule change continues to provide priority of Public Customer orders over Preferred Market Makers at the same price. The Exchange believes this priority is consistent with the purposes of the Act. The Exchange believes the Preferred Order allocation proposal is designed to promote just and equitable principles of trade and to protect investors and the public interest, because it recognizes the unique status of Public Customers in the marketplace by ensuring Public Customers maintain priority before any allocations afforded to Preferred Market Makers.

The Exchange believes that the proposed Preferred Order allocation changes are reasonable, equitable and not unfairly discriminatory. Giving Preferred Market Makers the small lot allocation preference and allocation priority of 60% of the remaining quantity of the Preferred Order in certain circumstances will provide important incentives for Preferred Market Makers to provide liquidity on BOX, which provides greater opportunity for executions, tighter spreads, and better pricing for all Participants. While the Commission has, in the past, been concerned about locking up larger portions of order flow from intra-market price competition, the Exchange believes that the proposed preferred allocation methods adequately

balance the aim of rewarding Preferred Market Makers by limiting the volume of small size orders executed by Preferred Market Makers to account for no more than 40% of the volume executed on the Exchange.

The Exchange believes that the Preferred Market Maker allocation is designed to promote just and equitable principles of trade and to protect investors and the public interest, because it strikes a reasonable balance between encouraging vigorous price competition and rewarding Market Makers for their unique duties. In order to receive an allocation preference, Preferred Market Makers must meet heightened quoting requirements as Market Makers, and also be quoting at the NBBO at the time the Preferred Order is received. Heightened quoting requirements mean that Preferred Market Makers must maintain a continuous two-sided market throughout the trading day, in 99% of the non-adjusted option series of each class for which it accepts Preferred Orders, for 90% of the time the Exchange is open for trading in each such option class.<sup>15</sup> Overall, the proposed changes to the Preferred Market Maker allocations represent a careful balancing by the Exchange with regard to the rewards and obligations of various types of market participants. The Exchange believes these requirements of Preferred Market Makers will provide an incentive for Market Makers to assume these additional responsibilities beyond those already required for Market Makers, which will facilitate improved trading opportunities on BOX for all Participants.

The Exchange believes this proposed rule change is a reasonable modification designed to provide further incentives and enhanced allocation to a Preferred Market Maker when it is

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<sup>15</sup> For purposes of this requirement, a Preferred Market Maker is not required to quote in intra-day add-on series or series that have a time to expiration of nine months or more in the classes for which it receives Preferred Orders and a Market Maker may still be a Preferred Market Maker in any such series if the Market Maker otherwise complies with Rule 7300(a)(2).

quoting at NBBO. The Exchange also believes that the proposed rule change will increase the number of transactions on the Exchange by attracting additional activity to the Exchange, which will ultimately enhance competition and provide customers with additional opportunities for execution.

The Exchange believes the proposed changes to the Preferred Order allocations are an improvement over the current allocation algorithm, and will benefit all market participants submitting Preferred Orders on the Exchange. Additionally, the Exchange believes that the proposed Preferred Order allocation algorithm will encourage greater participation by Market Makers to provide quotes on the Exchange as Preferred Market Makers. These additional responses should encourage greater competition on the Exchange, which should, in turn, benefit and protect investors and the public interest through the potential for greater volume of orders and executions.

For the foregoing reasons, the Exchange believes this proposal is a reasonable modification to its rules, designed to facilitate increased interaction of orders on the Exchange, and to do so in a manner that ensures a dynamic, real-time trading mechanism that maximizes opportunities for trading executions of orders. The Exchange believes it is appropriate and consistent with the Act to adopt the proposed changes.

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, the Exchange notes that the rule change is being proposed as a competitive response to the options exchanges with specialists. The Exchange believes that the proposed change will allow the Exchange to further compete with competitors that provide specialist assignments.

With respect to intra-market competition, the Exchange believes that the proposed change will promote competition by allowing multiple competing Preferred Market Makers per class.

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

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

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

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

- (A) by order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BOX-2018-20 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-BOX-2018-20. 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, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. 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-2018-20, and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

Eduardo A. Aleman,  
Assistant Secretary.

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<sup>16</sup> 17 CFR 200.30-3(a)(12).

[FR Doc. 2018-14112 Filed: 6/29/2018 8:45 am; Publication Date: 7/2/2018]