



BOXSM
REGULATION

Regulatory Circular

RC-2012-03

TO: BOX Participants

FROM: BOX Regulation

SUBJECT: Delta Hedge Exemption and Aggregation of Accounts for Position and Exercise Limit Purposes

DATE: May 1, 2012

Delta Hedge Exemption Becomes Operative

BOX Participants are now permitted to use the delta-based equity hedge exemption for position limits under Rule 3130 (b) (Equity Hedge Exemption) of the BOX Rules.

Aggregation of Accounts

The purpose of this memorandum is to summarize the provisions of BOX Rules with respect to the aggregation of accounts for position and exercise¹ limit purposes. BOX Rule 3120 (Position Limits) requires that positions maintained in accounts directly or indirectly controlled by the same individual or entity be aggregated for position and exercise limit purposes. Pursuant to Rule 3120, control exists when an individual or entity makes investment decisions for an account or accounts, or materially influences directly or indirectly the actions of any person who makes investment decisions. Control is also presumed in the following circumstances: a) among all participants of a joint account who have authority to act on behalf of the account; b) among all general partners to a partnership account; c) when an individual or entity holds an ownership interest of 10% or more in an entity, or shares in 10% or more of profits and/or losses of an account; d) when accounts have common directors or management; and e) where an individual or entity has authority to execute transactions in an account.

¹ The rule change does not change the options *exercise* limits in Rule 3140 (Exercise Limits) of the BOX Rules because such exercise limits only apply to the extent that position limits under Rule 3120 of the BOX Rules are imposed. Thus, as delta neutral positions would be exempt from position limits under the proposed rule change, such positions also would be exempt from exercise limits. Similarly, for positions held that are not delta neutral, only the option contract equivalent of the net delta of such positions would be subject to exercise limits.

Non-aggregation of Accounts

Demonstrating that control does not exist can rebut the presumption of control. The rebuttal proof must be submitted to BOX Regulation by affidavit and other documentation as may be appropriate. The decision to grant non-aggregation is not retroactive and is handled on a case-by-case basis. BOX Regulation has granted non-aggregation between the following accounts: between a market-maker's individual account and his joint account in which the market maker's participation in the joint account is limited to providing financial backing to the other member of the account; and between affiliated broker-dealers.

In situations involving requests for non-aggregation treatment between (1) affiliated broker-dealers, (2) broker-dealers and their non-broker-dealer affiliates, and (3) separate and distinct trading units within the same broker-dealer, BOX Regulation requires, at a minimum, the broker-dealer(s) to satisfy the following conditions:

- (i) Establish that the trading unit(s) requesting non-aggregation operates independently of other trading units of the broker-dealer, which must include the disclosure of the trading unit's trading objective;
- (ii) Create internal firewalls and information barriers to segregate the trading unit(s) receiving non-aggregation treatment from other trading units controlled by the broker-dealer that also have trading accounts;²
- (iii) Maintain all trading activity of the trading unit(s) requesting non-aggregation in a segregated account, which shall be reported to BOX Regulation as such; and
- (iv) Maintain regulatory compliance oversight and internal controls and procedures.

If BOX Regulation determines that the broker-dealer that requests non-aggregation treatment has successfully rebutted the presumption of control and grants non-aggregation status, the broker-dealer must, at a minimum, comply with the following requirements:

- (i) (i) Retain written records of information concerning the non-aggregated account, including, but not limited to, trading personnel, names of personnel making trading decisions, unusual trading activities, disciplinary action resulting from a breach of the broker-dealer's systems firewalls and information-sharing policies, and the transfer of

² BOX Regulation will review this category on a case-by-case basis. With respect to physical separation, the presumption of control becomes easier to rebut as the physical separation between the trading units increases. At a minimum, BOX Regulation will require trading units located on the same floor to be physically isolated from each other to the extent that BOX Regulation is assured that no communication will take place between individuals staffed in the applicable trading units. In addition, BOX Regulation will require system firewalls to be in place in order to prevent the flow of information (*e.g.*, trades, positions, trading strategies) between the trading unit(s) that receives non-aggregation treatment and other trading units controlled by the broker-dealer.

- securities between non-aggregated accounts, which information shall be promptly made available to BOX Regulation upon its request;
- (ii) Promptly provide to BOX Regulation a written report at such time that there is any material change with respect to the non-aggregated account, at which point BOX Regulation will re-examine the bases for its determination of non-aggregation;³ and
 - (iii) Provide an acknowledgement to the effect that BOX Regulation reserves the right to impose additional restrictions and conditions with respect to the granting and removal of non-aggregation as the circumstances warrant.

This memorandum is not intended to be a comprehensive description of all of the rules and requirements relating to the aggregation of accounts for position and exercise limit purposes. For a more detailed description of these rules and requirements, Participants are advised to refer to BOX Rule 3120 and any interpretations and policies thereunder.

Contacts

Please review the information provided herein. If you have any questions regarding this information, please contact Ken Meaden, Chief Regulatory Officer, at (617) 235-2258.

³ BOX Regulation reserves the right to freeze any position above the standard aggregation limit if it determines that aggregation is then appropriate due to changed circumstances.