

offer) of the National Best Bid Offer (NBBO) at the time of the commencement of the PIP.<sup>47</sup>

(3) Pilot Program—No Minimum Size Requirement for Price Improvement

BSE believes the customer protection benefits of the PIP process should be open to orders of all sizes since:

(a) The price to the Customer for PIP orders must better the prevailing NBBO;

(b) The price to the Customer is firm;

(c) The OFP and not the Customer bears the risk of market movements during the PIP; and

(d) The Customer is given an opportunity for further price improvement during the three second exposure period.

From the Customer's perspective, the only result of having the Customer's small order being ineligible for the PIP would be that the Customer's order would likely be filled at a price at least a penny worse than if it had been filled through the PIP.<sup>48</sup> Indeed, because of the relatively lower risk to the OFP and the Market Makers by virtue of the small size, there is a greater likelihood of price improvement to be provided by BOX Market Makers stepping in and participating in the PIP. On the other hand, creating a minimum size requirement would mandate that all small orders are automatically executed at the prevailing quotes with no opportunity for any price improvement. Consequently, BOX would have no minimum size requirement for orders entered into the PIP, for at least a Pilot Period to extend eighteen months from the day trading commences on BOX. During this Pilot Period, BOX would supply the Commission with data to support at least the following tenets:

(a) That there is meaningful competition for all size PIP orders;

(b) That there is significant price improvement for all orders executed through the PIP, and;

(c) That there is an active and liquid market functioning on BOX outside of the PIP mechanism.

Any data that is submitted to the Commission by the BSE during this Pilot Period and related directly to it, would be submitted on a confidential basis.<sup>49</sup>

(4) PIP Participants and Improvement Orders

Improvement Orders are specialized orders submitted in increments of \$.01 that are valid only in the PIP process. Improvement Orders may not be submitted in increments smaller than \$.01.<sup>50</sup> An Improvement Order is any order entered into the PIP by the OFP at a price better than the specified NBBO or any order entered by a Market Maker at or better than the OFP's Primary Improvement Order. PIP Participants would enter Improvement Orders seeking to gain priority to give the contra Customer Order an improved execution price over the NBBO. Only BOX Market Makers may submit competing Improvement Orders and only for those classes within their appointment. OFPs may submit Improvement Orders only in the PIP auction for which they have submitted the Primary Improvement Order.<sup>51</sup> The subsequent price modifications by the OFP to an OFP's Primary Improvement Order are treated as new Improvement Orders for the sake of establishing priority in the PIP process.<sup>52</sup> Market Makers and OFPs meeting the foregoing criteria would be deemed PIP Participants for that specific PIP only, and may continually submit competing Improvement Orders during that PIP.<sup>53</sup> Options Participants not deemed PIP Participants may nonetheless submit orders to the Trading Host during the PIP in order to compete; however, the normal price increments would apply to these orders.<sup>54</sup>

BOX Improvement Orders are firm and cannot be cancelled during the PIP. Thus, from the outset of the PIP, a Customer is guaranteed a locked-in trade at a price at least a penny better than the NBBO, and the OFP (and not the Customer) bears full market risk during the PIP. An OFP is not permitted to cancel its Primary Improvement Order or the Customer Order nor modify the size of its Primary Improvement Order at any time during the PIP, and may only modify the price of its Primary Improvement Order by improving it. A Market Maker, except for a Market

Maker that has submitted a Primary Improvement Order, may: (1) Submit a competing Improvement Order for any size up to the size of the Customer Order, (2) submit competing Improvement Order(s) for any price equal to or better than the Primary Improvement Order, (3) improve the price of his Improvement Order at any point during the PIP, and (4) decrease the size of his Improvement Order, but only if he improves the price of that order.<sup>55</sup>

(5) Competition During the PIP

At the conclusion of the PIP, the Customer Order would be matched in accordance with price/time priority against the best prevailing orders on BOX, whether Improvement Orders or subsequent "unrelated orders"<sup>56</sup> to the PIP that were received by BOX during the PIP process from non-PIP Participants.<sup>57</sup> Any portion of an Improvement Order left unfilled would be cancelled. The only exceptions to time priority in the PIP matching process concern limited priority accorded the OFP and Market Maker Prime at the PIP conclusion; these are described below in detail.<sup>58</sup>

In cases where an unrelated order on the same side as the Customer Order is submitted to BOX during a PIP, which is immediately executable (all or partially) against either an Improvement Order or an order on the BOX Book, the PIP would be concluded and the Customer Order would be matched with the Improvement Order(s) to the fullest extent possible. Improvement Orders would not be matched with unrelated orders; however, the Customer Order may be executed against unrelated orders where the latter have a better price than the Improvement Order.<sup>59</sup>

The BOX Rules provide strong incentives for both OFPs and Market Makers to compete aggressively for Customer Orders entered into the PIP process. First, in contrast to some other systems, under the proposed BOX Rules no one would get a "last look" to step

<sup>55</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(e)(ii), *The Price Improvement Period*.

<sup>56</sup> An "unrelated order" would be defined as a non-Improvement Order entered into the BOX market during a PIP. See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(a), *The Price Improvement Period*.

<sup>57</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(e)(iii), *The Price Improvement Period*.

<sup>58</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(f), *The Price Improvement Period* and Sec. 19, *Market Maker Prime*.

<sup>59</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(g), *The Price Improvement Period*.

<sup>47</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(e), *The Price Improvement Period*.

<sup>48</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18, *Supplementary Material, The Price Improvement Period*.

<sup>49</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18, *Supplementary Material, The Price Improvement Period*.

<sup>50</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(h), *The Price Improvement Period*.

<sup>51</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(e)(i), *The Price Improvement Period*.

<sup>52</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(e)(ii), *The Price Improvement Period*.

<sup>53</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(e)(i), *The Price Improvement Period*.

<sup>54</sup> See proposed BOX Rules, Chapter V, *Doing Business on BOX*, Sec. 18(e)(f)(g), *The Price Improvement Period*.