

As stated in the previous paragraph, similar to the fee charged to broker-dealers, there is a \$0.40 per contract fee for the execution against the exposure of an order which the Trading Host filters against trading through the NBBO, pursuant to the NBBO filter procedures set forth in Chapter V, Section 16(b) of the proposed BOX Rules. However, the motivation behind charging this fee to Market Makers is different than the motivation behind levying this fee to broker-dealers. The Exchange proposes to apply this fee to Market Makers so as to incent Market Makers to aggressively post quotations at the NBBO. That is, if a Market Maker establishes, or quotes at, the NBBO, the Market Maker would not be charged this fee as the NBBO filtering process would not be required. However, the BSE believes that this fee would not be of such a level so as to deter Market Makers from executing with orders exposed through the filtering process.

The BSE represents that the BOX market model features very low barriers to entry for Market Makers. All other U.S. options exchanges have costly barriers to entry for market making firms in their expenses for the purchase or lease of seats or trading bins, which run, in some cases, to as much as \$16,000,000. For example, on the ISE, a recent sale of a Series B-2 (CMM trading privileges) share was for \$1.6 million in Bin 5 on October 8, 2003, a bin covering only 60 of the 600 options classes presently listed on the ISE. Purchase of all 10 bins at that price would equal \$16,000,000.<sup>9</sup> BOX has no such costly seat or bin purchase or lease requirements and has structured its fees so as to render Market Maker appointments accessible to qualified firms. In addition, efficiencies gained by Market Makers using the BOX technology would allow them to manage more classes with less resources, significantly reducing operating costs when compared to traditional floor based exchanges.

#### i. Comparison of Market Maker Costs on BOX versus Floor-Based Exchange

The BSE estimates that a member-firm of a floor based options exchange would need a minimum of fifteen individuals to act as Market Makers in order to be able to effectively manage the trading of 250 classes. On BOX, the same result can be achieved with two to three traders acting in the capacity of Market Makers, thus accruing substantial cost

savings in salaries, bonuses and other personnel related costs alone, which, under a conservative estimate, could be at least \$1 million annually.

Additionally, all of the existing floor based options exchanges have various facility and floor related fees (which, in the case of some of the floor-based exchanges, are set forth in several pages of detail in their schedules of miscellaneous fees). These types of fees simply do not exist on BOX. Because of the considerable franchise related and other fixed costs<sup>10</sup> on the existing floor-based exchanges, it is difficult to make a meaningful item-by-item comparison with an all-electronic market structured like BOX. Nevertheless, the BSE believes that when all relevant costs are considered there is a strikingly higher overall trading cost to market makers for trading on one of the floor-based exchanges when compared to the cost of trading on BOX. While the per contract execution fees on BOX would be competitive with the existing exchanges, BOX Market Makers would not have to bear nearly the same level of fixed costs as do members of the existing exchanges.

#### ii. BOX Minimum Activity Charge ("MAC")

Another key feature of the BOX market model is an "open" policy regarding the number of Market Makers that are allowed to be appointed to any class after the first six months of trading, as compared to a "closed model" of specialists, Designated Primary Market Makers ("DPMs"), and PMMs on the other options exchanges. This unique approach is not without costs to BOX however. The key factor driving BOX costs is the total number of Market Maker appointments,<sup>11</sup> as BOX's hardware and telecommunication infrastructure must accommodate the heavy message traffic generated by Market Makers. Trade executions are expected to represent a small percentage of the overall BOX traffic, yet would

account for the majority of BOX's revenue.

The BSE believes that the low barriers to entry for the BOX market, coupled with the pent up demand for the ability to make markets in the U.S. options industry, as demonstrated by the number of market making applications for the proposed BOX market, would result in BOX having significantly more Market Makers per class than other markets.<sup>12</sup> Accordingly, the BSE could experience a financial burden in relation to its proposed BOX facility if it attempted to accommodate this extra demand by adding capacity to the BOX trading engine without some guaranteed off-setting revenue. Therefore, the pricing model proposed for the Market Maker firms is comprised of a Minimum Activity Charge (MAC) and a volume discount. The base trading fee per contract executed for a Market Maker is \$0.20. If a Market Maker's monthly trading activity is low, the MAC may be applicable. The actual MAC for a given options class would vary periodically with industry-wide trading volume, as determined by Options Clearing Corporation ("OCC") clearing data (see MAC Level chart below). If the total trading fees for a Market Maker in a given month do not exceed the total MAC for the classes for which a Market Maker holds appointments, Market Makers would be charged the MAC, rather than the trading fee. In no case would the MAC be charged in addition to the trading fees.<sup>13</sup>

Throughout the BOX development process, the BSE has strived to minimize the cost of entry to participants, while at the same time ensuring that BOX would recoup its operating costs. The MAC for each class was established to accomplish three objectives: (1) Recoup BOX's monthly operating costs; (2) provide one of the most cost competitive fee schedules in the U.S. options market; and (3) provide proper incentives for OFPs to send order flow to BOX.

<sup>12</sup> The BSE has received 54 Market Maker applications. 32 Market Makers are ready for the BOX launch and participated in the initial allocation of class appointments. Based on the appointments allocated, BOX would have an average of 14 Market Makers per class after the first six months of trading.

<sup>13</sup> For instance, if the total contracts traded in 25 classes in which a Market Maker holds appointments in a given month is 75,000 which, at the base trading fee rate of \$ 0.20 represent total trading fees of \$15,000, but the total MAC for the 25 classes is \$16,400, the Market Maker will be obligated to pay the MAC of \$16,400 for the month, rather than the calculated rate of \$15,000.

<sup>9</sup> BSE also notes that the last sale of a Primary Market Maker ("PMM") membership on the ISE was \$7.5 million on September 29, 2003. BOX has no PMM equivalent and therefore lacks this significant entry cost.

<sup>10</sup> For instance, on the CBOE, in addition to the substantial up front cost of buying a seat (last sale on October 21, 2003 was \$280,000), there are numerous one time and recurring facility charges such as booth fees, facilities fees, storage fees, access fees, in-crowd phone fees, maintenance fees, phonemail fees, coat room service fees, charges for lost or damaged jackets, badge fees, on-floor line fees, shelf rental fees, in-house pager fees, handset fees, satellite television fees, terminal rental fees, technology fees, paper ticket fees, and several others to which the BOX market has no counterpart.

<sup>11</sup> The total number of Market Maker appointments refers to the number of registered Market Makers per class. For example, if there are 100 classes with an average of ten Market Makers per class, there are 1,000 appointments.