



June 18, 2007

Heather Seidel  
Division of Market Regulation  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: **PENNY PILOT DATA REVIEW**

Dear Ms. Seidel,

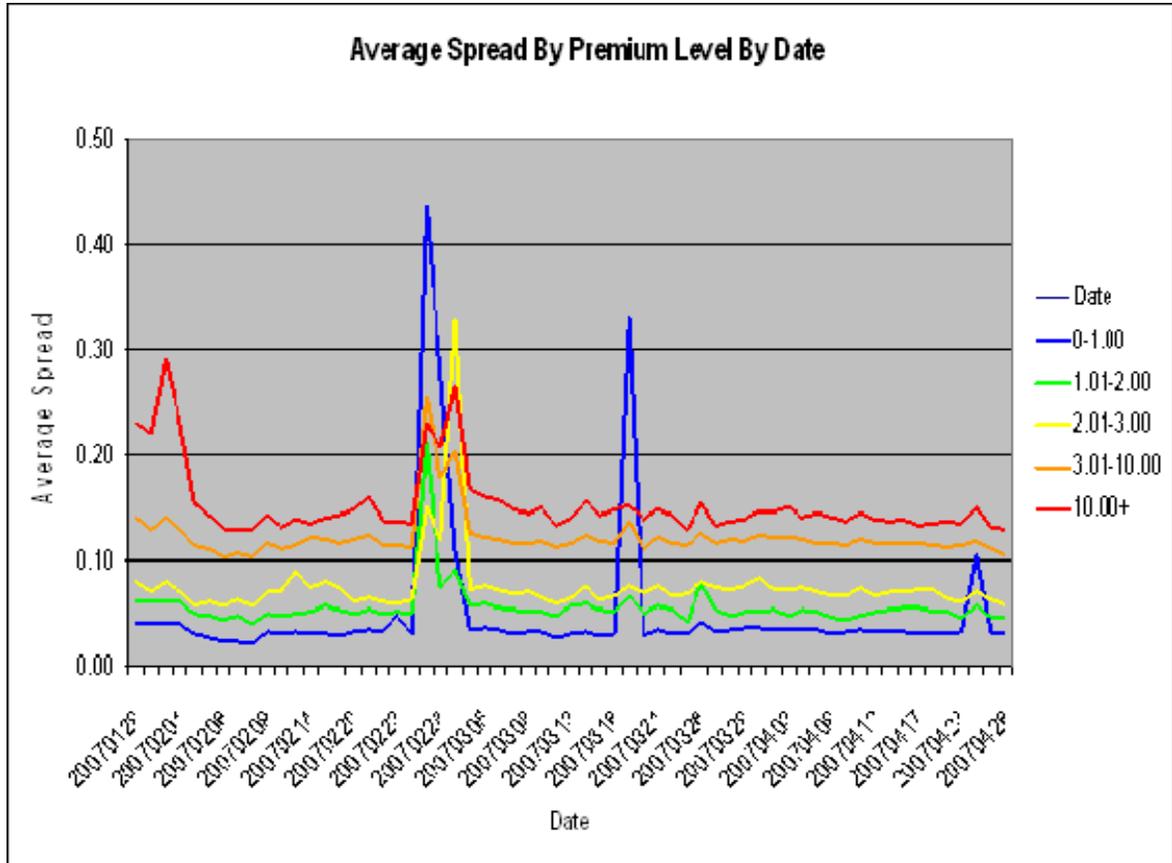
BOX has reviewed the Penny Pilot Program (“PPP”) data provided to the Commission as well as internal analyses done to compare a sampling of pre-pilot and post-pilot data in the 13 PPP issues. The following points summarize the data:

### **Bid/Offer Spreads**

- Spreads have narrowed considerably in the 13 PPP classes. Our own study, which includes spreads in all PPP series on BOX without regard to the premium level, indicates that the average spread on the pre-pilot sample days was \$0.1567 and dropped to \$0.1115 during the first several weeks of the pilot, an improvement of 29%.

Our sample data shows that five of six exchanges had significant drops in average spread, while one exchange showed a significant increase in average spread. Among the five exchanges with improved bid/offer spreads, the average spread dropped from \$0.1600 to \$0.1126 for an improvement of 30% which is in line with that experienced by BOX.

- Since the pilot began, with the exception of a few particularly volatile days, spreads by premium level have been quite stable since our original observations.

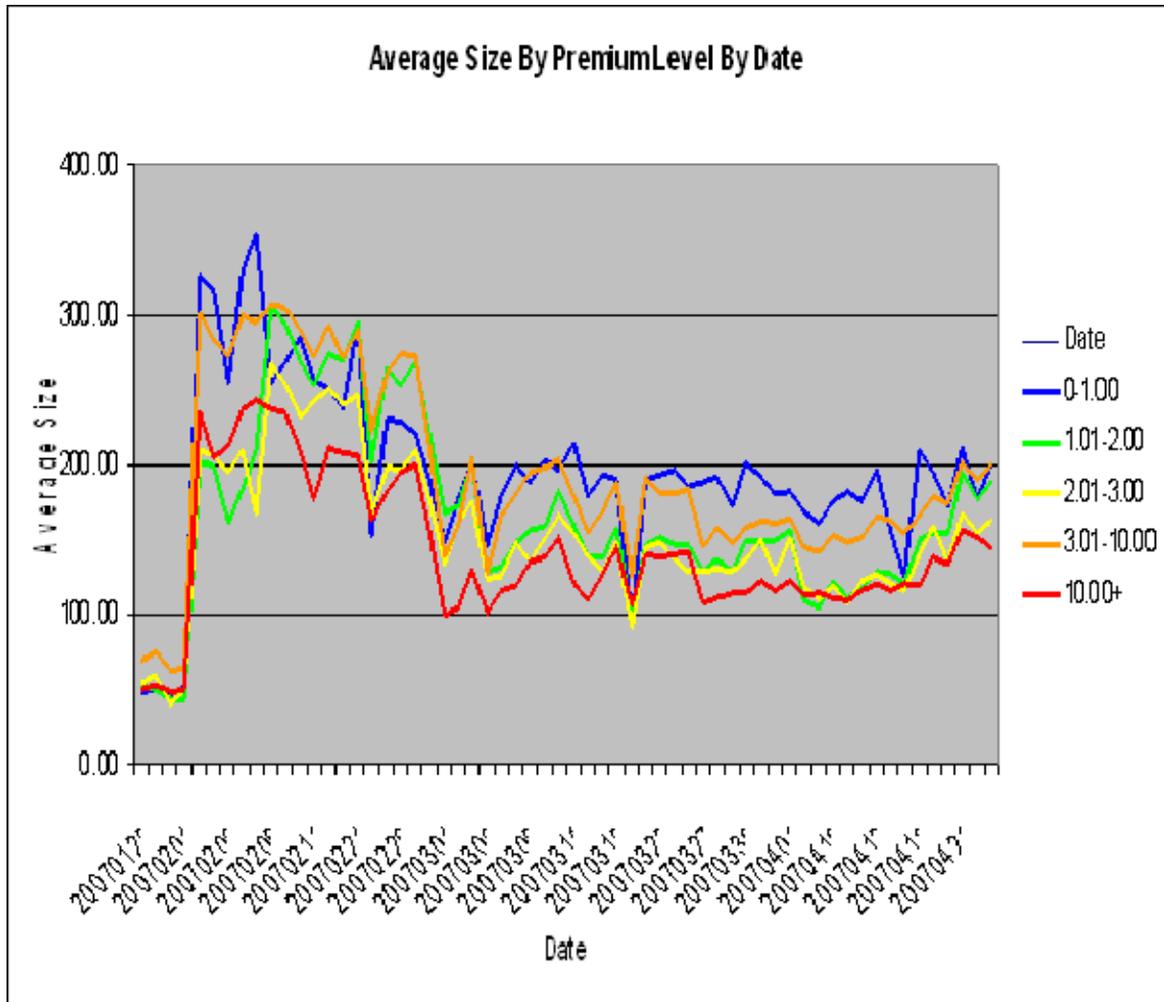


### Displayed Quote Size

- As expected, the displayed, “top of the book” **quote size** has dropped considerably in the 13 PPP classes. Our own study indicates that the average quote size in all PPP series on BOX without regard to premium level on the pre-pilot sample was 465 and dropped to 292 in the post-pilot sample days during the first several weeks of the pilot, a decrease of 37%.

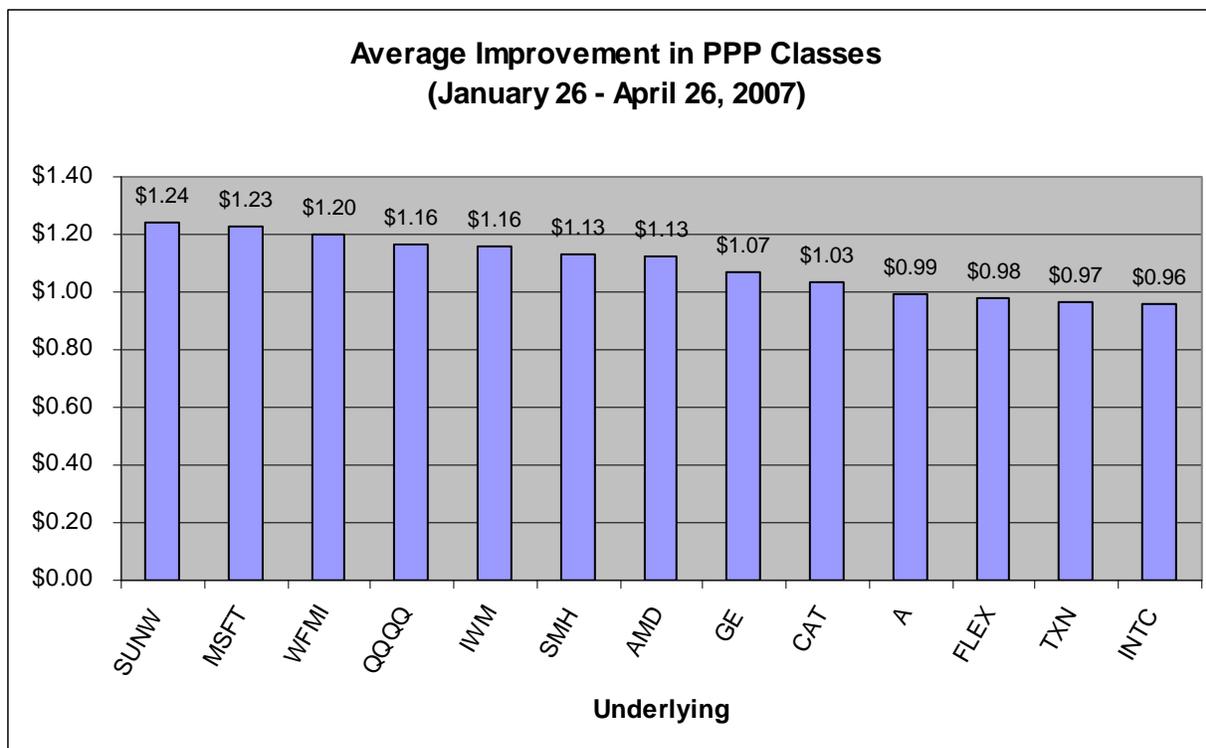
Our sample data shows that all six exchanges had significant drops in average quote size as the average for all six exchanges dropped from 486 to 371 or 32%.

- When the pilot began, quote size took a large initial drop. During February quote size continued to drop as the market slowly adjusted to the narrowed spreads. With the exception of a few volatile days, size by premium level was relatively stable in March and April. The stable level of quote size is somewhat lower than that in our post-pilot sample period.



### Improvement Amount (without PIP)

- Using a simple assumption that all trades on PPP classes would have otherwise occurred on the nearest “pre pilot” (e.g. nickel or dime) price increment, BOX estimates that trades on the PPP classes received an average price improvement of \$ 1.14 per contract. Significantly, this figure was fairly constant across all thirteen classes with only three classes averaging above \$ 1.20 and only four below \$ 1.00 (with none below \$ 0.96).



### PIP Improvement

- As expected, price improvement over the NBBO via BOX’s Price Improvement mechanism (“PIP”) has dropped significantly (more than 50%) both in terms of frequency (e.g. percentage of trades that were improved via the PIP) and magnitude (e.g. the average price improvement per contract for orders that were executed via the PIP). This was anticipated by BOX since the narrow NBBO spreads in the PPP classes means that there is less room for improvement over NBBO which is the condition for starting a PIP.

### Quote Traffic Mitigation

- Quote mitigation did not achieve targeted levels. On the other hand, the mitigation targets were not required as the explosion in quote update traffic anticipated by many observers did not materialize in the penny classes. The penny pilot has given BOX the opportunity to experiment with a variety of different mitigation parameters which will enable the exchange to configure its mitigation software with confidence in future to achieve whatever target is required.



## Conclusions and Recommendations

- The data indicates that customers have greatly benefited from narrower quotes during the pilot as witnessed by the large amount of price improvement achieved in the first two months of the PPP. Although published quote size has dropped, it remains well above the size of the typical public customer order which finds more than adequate liquidity to complete execution at a superior price resulting from narrowed spreads.
- Consequently, BOX recommends that the quotation in pennies of certain options classes be expanded as soon as practicable in order to deliver the proven benefits on a large number of options classes. We look forward to working with the Commission to determine the best way to reach this goal.

Please feel free to contact me at 617-235-2235 or at [lfall@bostonoptions.com](mailto:lfall@bostonoptions.com) if you have any other questions or concerns.

Sincerely,

Lisa J. Fall, Esq.  
General Counsel  
Corporate Secretary  
Boston Options Exchange Group, LLC