

*badge identification number on the trade tickets, identifying himself/herself as the Allocating participant in the particular trade. If the Allocating Participant is not a participant in the trade to be allocated, he/she shall identify himself/herself by initialing the trade tickets.*

## **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 Phlx 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 places specified in item IV below. The Exchange 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 purpose of the proposed rule change is to change the responsibility for options trade allocation to permit floor brokers to delegate this responsibility to the specialist.<sup>7</sup> The Exchange believes that this amendment should render the process of trade allocation more efficient, which in turn facilitates trade reporting. Trade allocation means, in this context, determining who is considered to be bidding or offering at a particular price, who participates in a trade, and for what size.<sup>8</sup>

Currently, Advice F-2 provides that in order to facilitate timely tape

reporting of executed trades, it is the duty of the largest participant in a trade to allocate, match, and time stamp manually executed trades,<sup>9</sup> as well as to submit the matched trade to the appropriate person at the respective specialist post immediately upon execution. Further, under the current rule, if there is only one seller and one buyer, the seller is responsible.

Advice F-2 was amended in 1998 to add a trade allocation provision and to specifically place that responsibility upon the largest participant involved in the trade, who is normally the floor broker representing the original order in the trading crowd.<sup>10</sup> At the time of this amendment, the Exchange noted that the practice in most options crowds was for the specialist to announce trade splits. The Exchange also noted that the practice differed throughout the floor, especially when the specialist was not involved in a trade, or where a great deal of trading and quoting activity rendered specialist allocation impractical. In these situations, floor brokers assisted in allocating trades, along with their other duties respecting trade tickets. Thus, the 1998 amendment was intended to both establish who is responsible for trade allocation as well as to select the largest participant (normally, the floor broker) as a logical extension of the then-existing responsibilities for matching and time stamping.

The proposed amendment to Advice F-2 would facilitate a voluntary shift in the responsibility for allocating trades from the floor broker to, generally (subject to delegation), the specialist. The proposal would require the floor broker to allocate trades (where a floor broker is a participant to a trade), recognizing the floor broker's unique position in asking for the market and hearing the responses. At the same time, it would allow the floor broker to delegate such responsibility to the specialist (if the specialist agrees to do so), recognizing the floor broker's desire to proceed to the next trade.

That delegation, which could also be made to someone assisting the specialist

under the specialist's direct supervision,<sup>11</sup> also acknowledges the specialist's general obligation to be present and aware of who is on what market. The Exchange anticipates that, generally, the delegation would be done across-the-board in a particular crowd, but understands that there are situations where the delegation may occur trade-by-trade, and even after a trade, in order to be responsive to the needs and relative activity level of particular specialists and floor brokers.

Since the 1998 amendment, for reasons relating to both business practices and technology, some floor brokers have found the responsibilities under the current version of Advice F-2 burdensome and impractical in many instances. Due to the changed role and reduced number of floor brokers, it may no longer make sense for floor brokers to have the sole responsibility to allocate trades on the Exchange floor. The number of orders received through the AUTOM System (not requiring a floor broker) has risen steadily, causing a declining role for floor brokers. The maximum size of orders eligible for AUTOM delivery has risen from 500 to 1,000 contracts, in response to competitive pressures.<sup>12</sup> At the same time, the number of options listed on the Exchange and overall volume have skyrocketed. Overall technological enhancements and changes in the operation and economics of the trading floor seem to indicate it would be more realistic for specialists, who are always present in the trading crowd, to assume this responsibility.

In trades not involving a floor broker or the specialist, the largest participant would continue to be responsible for trade allocation. For instance, where two Registered Options Traders sell to one Registered Options Trader, that one buyer would be the largest participant, and thus the allocating participant. Similarly, where there is one buyer and one seller (neither of whom is the specialist or floor broker), the seller would continue to be responsible for trade allocation. An example of this situation would be two Registered Options Traders trading with each other.

<sup>7</sup> On September 11, 2000, the Commission issued an Order Instituting Public Administrative Proceedings Pursuant to section 19(h) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, which requires the Exchange (among other respondent options exchanges) to implement certain undertakings. See Securities Exchange Act Release No. 43268 (September 11, 2000) ("Order"). One such undertaking, set forth in section IV.B.j. of the Order, requires each respondent exchange to adopt new, or amend existing, rules to include any practice or procedure, not currently authorized by rule, whereby market makers determine by agreement the spreads or option prices at which they will trade any option, or the allocation of orders in that option. Describing accurately who allocates trades is intended by the Phlx to capture in a rule activity that can be viewed as allocating trades.

<sup>8</sup> In a related proposal (File No. SR-Phlx-2001-39), the Phlx proposes to codify other practices relating to the allocation of trades that have developed on the Exchange's options floor, and relating to the Exchange's parity and priority rules. See Securities Exchange Act Release No. 47499 (March 13, 2003).

<sup>9</sup> Manually executed trades refers to trades other than AUTO-X trades (which are automatically executed by the AUTO-X feature of the AUTOM System, pursuant to Phlx rule 1080), which includes orders delivered by AUTOM, by the Floor Broker Order Entry System, as well as manually to the specialist. (AUTOM, an acronym for Automated Options Market, is the Exchange's electronic order delivery and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor.)

<sup>10</sup> See Securities Exchange Act Release No. 39889 (April 10, 1998), 63 FR 23331 (August 28, 1998) (SR-Phlx-97-51).

<sup>11</sup> See Option Floor Procedure Advice F-23, which provides in pertinent part that a specialist clerk, under the supervision of a specialist, may request the crowd's market in order to update disseminated markets or ascertain parity/priority splits in relation to the execution of an order. See Securities Exchange Act Release No. 33125 (November 1, 1993), 58 FR 59286 (November 8, 1993), (SR-Phlx-93-17). See also Phlx rule 748, which requires all employees to be supervised.

<sup>12</sup> See Securities Exchange Act Release No. 43115 (August 10, 2000), 65 FR 50262 (August 17, 2000) (File No. SR-Phlx-00-35).