

increase the size of Auto-Ex eligible orders for classes of multiply-traded options to match the automatic execution order size of any other options exchange, provided that the Exchange files with the Commission a proposed rule change pursuant to Section 19(b)(3)(A) of the Act.⁷ In April 2002, pursuant to Amex Rule 933, Commentary .03 and Section 19(b)(3)(A) of the Act, the Amex filed a proposed rule change with the Commission to increase its Auto-Ex eligible order size for QQQ options to up to 2,000 contracts for the two near-term expiration months and 1,000 contracts for all other expiration months in order to match Primary Market Makers' size guarantees in QQQ options on the International Securities Exchange, Inc. ("ISE").⁸ Since April 29, 2002, the Exchange represents that it has established an Auto-Ex eligible order size of 1,000 contracts for all QQQ options series. The Exchange states that, to date, it is unaware of any increased risks to market participants and the marketplace as a result of the greater Auto-Ex eligible order size for QQQ options.

The Exchange also believes that the current Auto-Ex eligible order size of up to 250 contracts for all other options classes at the Exchange has similarly not created greater financial risks or other known system difficulties. The Exchange has set the Auto-Ex order size to the 250-contract maximum in a number of actively-traded option classes that, the Exchange believes, are the classes with the greatest liquidity and trading interest. The Exchange notes that options in Microsoft Corporation (MSFT) and General Electric Co. (GE) have Auto-Ex order sizes of 250 contracts. The Exchange states that market participants have further indicated that even larger sizes would provide greater benefits to their customers and proprietary trading strategies. The Exchange maintains that an increase in the permissible size of orders executable through Auto-Ex will provide more efficient executions due to the speed of execution obtained by Auto-Ex versus manual handling. The Exchange states that customers and other market participants are increasingly demanding that the Exchange automatically execute larger option order sizes that in the past would have received manual handling. The

Exchange believes that an increase in the Auto-Ex eligible order size of up to 500 contracts will meet this demand of the marketplace.

The Exchange's Auto-Ex system provides that all customer and broker-dealer market and marketable limit orders within the appropriate size parameters are executed at the prevailing best bid or offer, with both the specialist and registered options traders ("ROTs") as the contra-party to the transaction. Auto-Ex trades are automatically allocated on a rotating basis to the specialist and to each ROT that has signed on to Auto-Ex.⁹ If an Auto-Ex trade is greater than ten contracts, the Auto-Ex system divides the execution into lots of ten or fewer contracts and allocates a lot to each Auto-Ex participant.¹⁰ Accordingly, for actively-traded option classes in large trading crowds, the Auto-Ex allocation of executed contracts into lots of 10 contracts operates so that an Auto-Ex size of 250 contracts would be spread out among several ROTs, thereby significantly reducing the potential financial risk that a single ROT may incur. The Exchange believes that an increase of the Auto-Ex eligible size to 500 contracts will not significantly increase the financial risks of ROTs for such actively-traded option classes.

The Exchange believes that market participants desire and will support an increase in Auto-Ex eligible sizes of up to 500 contracts. The Exchange represents that, as of April 29, 2002, it has established an Auto-Ex size of 1,000 contracts for all QQQ options series. The Amex believes that the proposed increase in Auto-Ex eligible size for all other options is necessary in order for the Exchange to address market demands and for the purpose of competing effectively with other options exchanges that may not be so restricted.

The Amex notes that the Chicago Board Options Exchange, Inc. ("CBOE") has received regulatory approval, with respect to option classes that disseminate quotations with size, to automatically execute orders in such options through its RAES system up to the disseminated size, which may be larger than 250 contracts.¹¹

⁹ At the start of each trading day, the order in which trades are allocated to the specialist and traders signed on to Auto-Ex is randomly determined.

¹⁰ For example, an option class that allows up to 50 contracts to be executed through Auto-Ex would have a trade of 25 contracts divided into lots of 10, 10 and 5. See Securities Exchange Act Release No. 47229 (January 22, 2003), 68 FR 5060 (January 31, 2003) (File No. SR-Amex-00-30).

¹¹ See Securities Exchange Act Release No. 45676 (March 29, 2002), 67 FR 16478 (April 5, 2002)

Furthermore, the Amex notes that the ISE automatically executes a customer order for the disseminated quote size once such order hits the available option quote.¹² The Amex notes that, as a result, the disseminated size for a particular option quote is the actual size of an order that will be automatically executed. Accordingly, the Amex believes that, based on competitive considerations, an increase in the maximum Auto-Ex eligible order size will provide customers with increased opportunities for better and more efficient executions.

The Exchange represents that Auto-Ex has been successful in enhancing execution and operational efficiencies for certain option classes. The Exchange believes that automatic executions of orders for up to 500 contracts will allow for the quick, efficient execution of public customer orders, as well as broker-dealer orders on a case-by-case basis consistent with the Exchange's recent ability to provide automatic executions of broker-dealer transactions.¹³

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of section 6 of the Act.¹⁴ Among other provisions, section 6(b)(5) of the Act requires that the rules of an exchange be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating securities transactions, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.¹⁵

While increasing the maximum order size limit from 250 contracts to 500 contracts for automatic execution eligibility by itself does not raise concerns under the Act, the Commission believes that this increase

(CBOE File No. 2001-70); see also CBOE Rule 6.8 (c)(v) and Commentary .09 to CBOE Rule 6.8.

¹² See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000). The ISE operates an electronic marketplace where orders and quotes are entered into a central order book. Trades are then executed automatically when orders and quotes match.

¹³ See Securities Exchange Act Release No. 46479 (September 10, 2002) 67 FR 58654 (September 17, 2002).

¹⁴ The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78f(b)(5).

⁷ 15 U.S.C. 78s(b)(3)(A).

⁸ See Securities Exchange Act Release No. 45828 (April 25, 2002), 67 FR 22140 (May 2, 2002). The Amex rule change with respect to maximum Auto-Ex size for the QQQ options was filed with the Commission as a proposed rule change effective on filing pursuant to Section 19(b)(3)(A) of the Act, 15 U.S.C. 78s(b)(3)(A).