

change was published for comment in the **Federal Register** on June 28, 2000.³ On August 25, 2000, August 30, 2001, February 19, 2002, April 22, 2002, September 16, 2002, and December 20, 2002, respectively, the Amex filed Amendment Nos. 1, 2, 3, 4, 5, and 6 to the proposed rule change.⁴ These amendments were published for comment in the **Federal Register** on January 31, 2003.⁵ The Commission received no comments on the proposed rule change, as amended. On April 3, 2003, Amex filed Amendment No. 7 to the proposed change.⁶ This order approves the proposed rule change, as amended; grants accelerated approval to Amendment No. 7; and solicits comments from interested persons on that amendment.

II. Description of Proposal

The Amex proposes to codify in Rule 933(d), Commentary .06 to Rule 950(d), and Commentary .03 to Rule 950(n), current practices regarding the participation in option trades executed on the Exchange by registered options traders and specialists and the

allocation of those trades to the appropriate party. The proposed rule change also would provide clarity concerning the allocation of an options trade among the specialist and registered options traders when a customer order is on parity.

A. Specialist Participation

Generally, Amex Rule 126 (made applicable to options trading by Amex Rule 950 (d)) provides that when bids (offers) are made simultaneously, all such bids (offers) are on parity, and any securities sold (bought) in execution of such bids (offers) are to be divided as equally as possible between those on parity up to the participants' stated or generally known sizes.

The Amex states, however, that a practice has developed in Amex trading crowds in many option classes to give the specialist a greater than equal share when he or she is on parity with registered options traders. The Exchange proposes to codify this practice.

The proposed rule change would set forth that the size of the specialist's participation in the number of option contracts executed is based on the number of traders on parity.⁷ The proposed distribution of option contracts between the specialist and the traders on parity is as follows:

Number of traders on parity	Approximate number of option contracts (in percent)	
	Allocated to the specialist	Allocated to the traders (as a group)
1	60	40
2-4	40	60
5-7	30	70
8-15	25	75
16 or more	20	80

B. Allocation of Contracts Among Registered Options Traders

Once the specialist has determined and deducted his or her portion of the trade depending upon the number of traders on parity, the proposed rule

change provides that he or she would allocate the remaining contracts to the registered options traders.

As a preliminary matter, the proposed rule change sets forth that registered options traders must announce, either at the start of the trading day, upon entry into the trading crowd, or prior to the dissemination of a quotation, the number of contracts for which they are willing to participate.⁸ When it is the specialist's obligation to allocate the trade,⁹ he or she would allocate the portion of the order allotted to the registered options traders as a group based on the following provisions:

1. If all participants have equal stated sizes, their participations will be equal.

2. If participants' stated sizes are not equal, their participations will depend upon whether the number of executed contracts left to be allocated exceeded the participants' aggregate stated sizes.

3. If the number of executed contracts left to be allocated does not exceed the participants' aggregate stated sizes, the specialist will allocate the executed contracts equally, unless a participant's stated size is for an amount less than an equal allocation. In such case, the smallest sizes will be allocated first, until the number of executed contracts remaining to be allocated require an equal allocation.

4. If the number of executed contracts left to be allocated does exceed the participants' aggregate stated sizes, the specialist will allocate the executed contracts by first allocating to each participant the number of executed contracts equal to each participant's stated size, with the remainder being allocated based on the percentage a participant's stated size is of the participants' aggregate stated size.¹⁰

The proposed rule change provides further that in the event a specialist or registered options trader declined to accept any portion of the available contracts, any remaining contracts would be apportioned among the remaining participants who bid or offered at the best price at the time the market was established in accordance

³ See Securities Exchange Act Release No. 42964 (June 20, 2000), 65 FR 39972 (June 28, 2000).

⁴ Amendment Nos. 1 and 2 concerned the allocation of an order when a customer order is on parity with the specialist and/or a registered options trader. Amendment Nos. 3, 4, and 5 provided further clarity on trade allocation, and were submitted by Amex in compliance with Section IV.B.j. of the Commission's Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, Securities Exchange Act Release No. 43268 (September 11, 2000) ("Order"). Section IV.B.j. of the Order requires that respondent options exchanges adopt new, or amend existing, rules to set forth any practice or procedure "whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option class, or the allocation of orders in that option class." Amendment No. 6 made minor revisions to the proposal.

⁵ See Securities Exchange Act Release No. 47229 (January 22, 2003), 68 FR 5060 (January 31, 2003) ("January 2003 Notice").

⁶ See letter from Claire P. McGrath, Senior Vice President and Deputy General Counsel, Amex, to Elizabeth King, Associate Director, Division of Market Regulation ("Division"), Commission, dated April 2, 2003. Amendment No. 7 added proposed rule text permitting a registered options trader to direct his or her participation to a competing public order in the trading crowd. Although the narrative section of the January 2003 Notice indicated that a registered options trader, in addition to a specialist, could direct his or her participation in this manner, the proposed text of the rule omitted reference to a registered options trader. See *infra* at note and accompanying text. Amendment No. 7 further amended the proposed rule text to clarify how registered options traders would allocate the order of a registered options trader among themselves when the specialist is not participating, but a floor broker representing a customer order did seek to participate. See *infra* at note and accompanying text. Amendment No. 7 also made a technical correction to the rule text.

⁷ Commentary .06(i) to Rule 950(d). The percentages indicated above would apply only when the specialist and/or registered options traders are on parity and would not include situations where a customer order is also on parity with the specialist and registered options traders. See *infra* Section II.C.

In addition, neither the specialist nor a registered options trader would be allocated more executed contracts than the number of contracts representing the specialist's or the registered options trader's portion of the aggregate quotation size that the responsible broker or dealer would be obligated to communicate to the Exchange pursuant to Exchange Rule 958A(c), except when the number of executed contracts to be allocated exceeded the aggregate quotation size disseminated for that options series. Commentary .06(i) to Rule 950(d).

⁸ Commentary .03(a)(i)-(ii) to Rule 950 (n). The Exchange represents that these generally known sizes would be aggregated into the size disseminated by the Exchange pursuant to Amex Rule 958A so that the disseminated quote in each option series would reflect the level of participation by the specialist and each registered options trader. While the specialist would not be required to announce his or her size to the crowd, that size could be determined from the disseminated quote size.

⁹ See *infra* Section II.D. on responsibility for allocating trades.

¹⁰ See January 2003 Notice for an elaboration of these provisions, including examples of their application.