

with the provisions described above.¹¹ In such instance, the Exchange represents, the specialist's participation would be based upon one less registered options trader participating and the allocation among the registered options traders would be increased proportionately.¹²

C. Customer Orders and Specialist and Registered Options Traders on Parity

As indicated above,¹³ the allocation of an incoming order differs when a customer order is also on parity with the specialist and registered options traders. By way of background, Amex Rules 155 and 111 set forth the obligations and responsibilities of specialists and registered options traders when they handle or interact with customer orders.¹⁴ Amex Rule 155 requires a specialist to yield precedence to orders entrusted to him or her as agent before executing a purchase or sale at the same price for an account in which he or she has an interest. Commentary .07 to Amex Rule 111 provides that a registered options trader, in establishing or increasing a position, may not retain priority over or have parity with an off-floor order (*i.e.*, a customer order). Thus, as explained by Amex,¹⁵ Rules 155 and 111 require that, when the specialist as agent receives a customer marketable limit order, the specialist and any registered options trader establishing or increasing a position must yield precedence to the customer order. A registered options traders closing or reducing a position and a specialist not acting in an agency capacity can be on parity with a customer order.

The proposed rule change clarifies that when a customer order is competing on parity¹⁶ for an incoming order, the specialist would allocate executed contracts on an equal basis to the customer and to the specialist and/or any registered options traders on parity with the customer. Any contracts

that remained would be allocated, as between the specialist and the registered options traders as a group, in accordance with the percentages set forth in the table above.¹⁷

Further, although, as discussed above, Exchange Rules 111 and 115 do not require the specialist and registered options traders to yield priority in all circumstances to a customer order, the proposed rule change permits the specialist or a registered options trader to direct some or all of their participation to competing public orders (*i.e.*, competing orders for the accounts of non-broker-dealers) in the crowd.¹⁸

D. Responsibility for Allocating Trades

The proposed rule change sets forth that, for trades in which the specialist is participating, it is the specialist's responsibility to allocate executed contracts among all the participants in the trade.¹⁹ The specialist would be required to allocate the contracts according to the allocation method described above.

The proposed rule change further specifies the party who would be responsible for allocating a trade that occurs without the participation of a specialist. When a floor broker is representing the contra-side of the trade, the floor broker would be required to distribute the contracts equally among the participating registered options traders, unless a registered options trader's portion of the disseminated quote size is less than an equal distribution. In the latter case, the registered options trader would be given a less than equal distribution and the remaining contracts would be allocated equally among the remaining participants to the trade.²⁰

When neither the specialist nor a floor broker representing a customer as the contra-side of the trade is participating in the trade,²¹ the registered options

traders would allocate the executed contracts among themselves and other participants on parity in accordance with the same provisions setting forth allocations by the specialist.²² The Amex represents that in these situations, as well as others, registered options traders are only required to participate up to their portion of the Exchange's disseminated quote size.²³

E. Auto-Ex Trades

The proposed rule change also codifies Amex's procedures regarding the allocation of options trades executed through the Exchange's Auto-Ex system.²⁴ Such trades are automatically allocated on a rotating basis to the specialist and to each trader who has signed on to Auto-Ex, with the specialist receiving a larger than equal share. Under the proposed rule change, the rotation would be designed to provide that Auto-Ex trades over the course of a day in a given option class are allocated, as between the specialist and traders signed on to Auto-Ex for that class, in approximately the same percentages that the specialist and traders are allocated their respective portions of non-Auto-Ex trades—*i.e.*, depending upon the number of traders participating—as set forth in the table in Section II.A. above.²⁵

III. Discussion

After careful consideration, the Commission has determined to approve the proposed rule change.²⁶ For the

allocate the contracts among themselves and the floor broker in accordance with the rule governing how a specialist allocates an order, as indicated above. Amendment No. 7 also included the phrase "and other participants on parity" to clarify that a floor broker representing a customer in this manner would be included in the allocation. Telephone conversation between Claire P. McGrath, Senior Vice President and Deputy General Counsel, Amex, and Ira Brandriss, Special Counsel, Division, Commission, on March 31, 2003.

²² See Commentary .03(a)(iii) to Rule 950(n).

²³ See Amex Rule 958A.

²⁴ Auto-Ex automatically executes public customer market and marketable limit orders of a minimum of 10 and a maximum of 500 contracts, generally, in equity and index options. See Securities Exchange Act Release No. 47429 (March 3, 2003), 68 FR 11418 (March 10, 2003). In Nasdaq-100 Tracking Stock ("QQQ") options, the maximum Auto-Ex size is 2,000 contracts for the two near-term expiration months, and 1,000 contracts for all other expiration months. See Securities Exchange Act Release No. 45828 (April 25, 2002), 67 FR 22140 (May 2, 2002). Both the specialist and registered options traders are contra-parties to the trades executed on the Auto-Ex system. If an Auto-Ex trade is greater than ten contracts, Auto-Ex divides the execution into lots of ten or fewer contracts and allocates a lot to each Auto-Ex participant.

²⁵ Rule 933(d). Further details are described in the January 2003 Notice.

²⁶ In approving this proposed rule change, the Commission has considered its impact on

¹¹ Commentary .03(iv) to Rule 950(n). The Exchange states that if a specialist or registered options trader declined an allocation or "backed away" from his disseminated size in whole or in part, he or she would be in violation of the firm quote rule (see Amex Rule 958A), investigated, and sanctioned accordingly. See January 2003 Notice. However, Commentary .03(iv) would also apply when the size of the incoming order exceeded the disseminated size and one or more registered options traders were not willing to participate in a size larger than their disseminated size.

¹² See January 2003 Notice.

¹³ *Supra*, note .

¹⁴ Rule 155 is made applicable to options trading by Rule 950(a) and Rule 111 is made applicable to options trading by Rule 950(c).

¹⁵ See January 2003 Notice.

¹⁶ A specialist can be on parity with a customer only when the specialist is not representing the customer's order.

¹⁷ Commentary .06(ii) to Rule 950(d) and Commentary .03(a)(iii)(A) to Rule 950(n). Commentary .03(a)(iii) provides that the allocations are to be made "to the extent mathematically possible" according to the method set forth in the rule.

¹⁸ Commentary .03(a)(v) to Rule 950(n) as amended by Amendment No. 7. See *supra* note .

¹⁹ Commentary .03(a) to Rule 950(n).

²⁰ Commentary .03(b) to Rule 950(n).

²¹ See Amendment No. 7, in which Amex amended the proposed text of Commentary .03(b) so that it refers to a situation where neither the specialist nor a floor broker representing a customer "as the contra-side of the trade" is participating in the trade. The intent of the added language is to clarify that this provision relates to a situation in which the bid or offer being filled is that of a registered options trader, not of a customer represented by a floor broker. If, in such a situation, a floor broker representing a customer seeks to participate with the other traders in the crowd in filling the first trader's order, the traders would