

reasons discussed below, 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, with the requirements of Section 6(b)(5) of the Act.²⁷

The proposed rule change would codify the existing practice in many Amex options trading crowds to give the specialist a greater than equal share when on parity with registered options traders, specifying the extent of a specialist's enhanced participation according to the number of traders on parity as discussed above.²⁸ The Exchange believes that it is necessary to provide an enhanced participation in order to attract and retain specialists that are willing to accept the added responsibilities imposed on specialists and the costs that are incurred in meeting these obligations.²⁹ The Exchange also believes that such enhanced participations are necessary for it to remain competitive with other exchanges that currently offer enhanced participation to their specialists and primary market makers, and to give specialists the ability to attract order flow to the Exchange and its customers with tighter, more competitive markets.³⁰

The Commission believes that such participation guarantees are reasonable and are within the business judgment of the Exchange, as long as such advantages do not restrain competition and do not harm investors. The Commission notes that the proposed enhanced participations would not exceed 40 percent of an order (except when there is only one registered option trader on parity with the specialist). The Commission has found with respect to participation guarantees in other contexts that a maximum guarantee of 40 percent (where more than one trader is on parity with the specialist) is not inconsistent with statutory standards of competition and free and open markets.³¹

efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²⁷ 15 U.S.C. 78f(b)(5). Section 6(b)(5) of the Act requires that the rules of an exchange, among other things, be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to 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; and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

²⁸ *Supra* Section II.A.

²⁹ See January 2003 Notice.

³⁰ *Id.*

³¹ See, e.g., Securities Exchange Act Release Nos. 42455 (February 24, 2000), 65 FR 11388 (March 2,

The Commission further believes that the proposed rules set forth a reasonable method to be used by the specialist in allocating the remaining contracts among the registered options traders.³² This method is based on the size of each individual trader's interest as announced in advance.³³ The Commission also believes that the proposed method for the allocation of contracts that are declined by a specialist or registered options trader is fair and reasonable.³⁴

When a specialist represents a customer order, such as when a customer order is in the specialist's limit order book, the specialist must yield to the customer order. The proposed rule change provides an articulated sequence for allocating a trade in a situation where a customer order is on parity with the specialist and registered options traders. Specifically, the proposed rule change stipulates that the specialist must first allocate contracts on an equal basis to the customer and those participants on parity with the customer, before dividing the remainder of the order among the specialist and registered options traders who are not on parity.³⁵ The Commission believes this provision to be reasonable, given the Exchange's longstanding rules that permit a specialist or a registered options trader closing a position to be on parity with a customer.³⁶ At the same time, the proposed rule change would make clear that specialists and/or registered options traders may direct some or all of their participation to competing public orders, codifying a practice described by the Exchange of accommodating customer orders in this manner.³⁷ The Commission believes that such accommodation of public customers is both reasonable and appropriate.

The Commission believes that it is reasonable to assign responsibility for allocating a trade generally to the specialist,³⁸ by virtue of the specialist's central role in the execution of trades and his or her awareness of the generally known sizes of registered

2000) at 11398; and 43100 (July 31, 2000), 65 FR 48778 (August 9, 2000) at notes 96–99 and accompanying text.

³² *Supra* Section II.B.

³³ *Id.*

³⁴ *Supra* notes—and accompanying text.

³⁵ *Supra* Section II.C.

³⁶ The Commission notes that the Amex has filed a proposed rule change that would provide that a specialist or registered options traders may not have priority over or be on parity with a public customer order. See File No. SR-Amex-2003-07, available at the Amex and at the Commission's Public Reference Room.

³⁷ See January 2003 Notice.

³⁸ Section II.D. above.

options traders in the crowd and of customer interest. It is further reasonable, in the Commission's view, to assign the responsibility of allocation to the floor broker when the floor broker is representing the order that is being filled, and to the registered options traders when such traders are trading among themselves.³⁹ The Commission notes that while registered options traders would allocate the order among themselves in accordance with the same provisions that govern allocation by a specialist, a floor broker would be obligated to distribute the contracts among the traders on parity on an equal basis. The Commission believes it is reasonable to make this distinction in order to permit the floor broker, who may not be as conversant with the respective sizes of participating traders, to expeditiously allocate the order in an equitable manner.

The Commission further believes that the proposed rule regarding the allocation of Auto-Ex trades,⁴⁰ which would award the specialist and traders signed on to Auto-Ex throughout the day percentages that are the approximate equivalent of their respective entitlements in non-Auto-Ex trades, is a reasonable manner in which to apportion such trades.

The Commission finds good cause, consistent with Sections 6(b)(5)⁴¹ and 19(b)(2)⁴² of the Act, for approving Amendment No. 7 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 7 corrected the proposed rule text to reflect a proposed change that was described in the narrative portion of the January 2003 Notice, but was omitted from the proposed rule's text as published. The corrected version states that a registered options trader, as well as a specialist, may direct his or her participation to a competing public order.⁴³ As already noted above, the Commission believes that such accommodation of public customer orders is reasonable and appropriate.⁴⁴ Amendment No. 7 also clarified that when a transaction occurs without the participation of a specialist, and the bid or offer of a registered options trader is being filled, the registered options traders seeking to participate would include in the allocation a floor broker representing a customer order who was also seeking to

³⁹ *Id.*

⁴⁰ *Supra* Section II.E.

⁴¹ 15 U.S.C. 78f(b)(5).

⁴² 15 U.S.C. 78s(b)(2).

⁴³ See *supra* at text accompanying note .

⁴⁴ *Supra* at text accompanying note.