

trading by 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) shall be divided as equally as possible between those on parity up to the participants' stated or generally known sizes. In addition, as further discussed below, the trading crowds in many option classes give the specialist a greater than equal share when on parity with registered options traders. This proposal seeks to codify in the Exchange's rules these current allocation practices.

Although this rule proposal seeks to codify specifically the participation in and allocation of trades among specialists and registered options traders on parity, the Exchange notes that the Commission staff has requested a general description of the Exchange's rules regarding customer priority and parity. The following is a discussion of those rules: Exchange Rules 155 and 111<sup>6</sup> set forth the obligations and responsibilities of specialists and registered options traders, respectively, when they handle or interact with customer orders. Rule 155 requires a specialist to yield precedence to orders entrusted to him as agent before executing a purchase or sale at the same price for an account in which he has an interest. Rule 111, Commentary .07 provides that registered options traders in establishing or increasing a position may not retain priority over or have parity with a customer order. Thus, Rules 155 and 111 require that, when the specialist as agent receives a customer marketable limit order, he and any registered options trader establishing or increasing a position must yield precedence to the customer order. Registered options traders closing or reducing a position and specialists not acting in an agency capacity can be on parity with a customer order.

Amendment No. 2 to the proposed rule change, which was submitted to the Commission in response to a specific question from the staff, sought to further describe how customer orders are handled when they are on parity with registered options traders. The example given in Amendment No. 2 stated the general proposition that if a customer order can be filled completely, it will be, before the specialist and registered options traders participate for their own accounts. The example is a correct description of what generally occurs on the Exchange's trading floor as the

specialist and traders comply with the requirement that they generally deal for their own account only when there is a disparity between the supply of or demand for option contracts of the same series. Exchange priority and parity rules do not require the specialist and registered options trader to yield priority or parity in all circumstances to completely fill a customer order. Thus, if Exchange rules were strictly applied to the two examples posed in Amendment No. 2, the following would result:

(1) The specialist, one registered options trader (closing) and a customer (represented by a floor broker) are all bidding the same price, at the same time, for the same series of XYZ options and are, therefore, on parity. An incoming order to sell 300 XYZ contracts would be split evenly among the three participants.

(2) The specialist and a customer (represented by a floor broker) are bidding the same price, at the same time, for the same series of ABC options, and a registered options trader (opening) is also bidding at that same price and, thus, is not on parity. An incoming order for 300 ABC contracts would be split evenly between the specialist and the customer up to the size of the customer's order with the specialist receiving the same amount as the customer. Any remaining contracts would be split between the specialist and trader according to the percentages set forth in the proposed rules.

Notwithstanding the foregoing, specialists and registered options traders often do accommodate customer orders beyond what is required by Exchange rules as a means for attracting and retaining order flow in the increasingly competitive options markets. As a result, proposed Rule 950(n), Commentary .03(a)(v) would provide that the specialist and/or registered options traders may 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. The Amex believes that this proposed provision would help to result in customers receiving allocations as described in Amendment No. 2, *i.e.*, an allocation beyond what is required by Exchange rules. In addition, specialists and registered options traders must comply with the requirement, noted above, that they trade for their own accounts only when there is a lack of supply and demand.

It is the specialist's responsibility to allocate executed contracts among all participants to a trade. This is generally a manual process involving the

inputting of participant information into the Amex Order Display Book ("AODB").<sup>7</sup> However, as provided in proposed Commentary .03(b) to Rule 950(n), whenever a trade occurs without the participation of the specialist (*e.g.*, the order is represented by a floor broker with registered options traders as contra-parties to the trade), the Floor Broker representing the contra-side of the trade would distribute the executed 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. That 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. In addition, when only registered options traders are on both sides of a trade (*i.e.*, neither the specialist nor a customer is participating in the trade), the registered options traders would allocate the executed contracts among themselves in accordance with the same provisions setting forth allocations by the specialist. (*See* proposed Rule 950(n), Commentary .03(a)(iii) 1.-5.) 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. (*See* Amex Rule 958A).

Depending upon the level of activity and volatility of a particular option series, the level of participation of an individual registered options trader in each options series will vary. Registered options traders who regularly or only occasionally trade a particular option series are currently expected to and will be required under the proposed codification in Rule 950 (n), Commentary .03(a), to 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. These generally known sizes will be aggregated into the size disseminated by the Exchange pursuant to the firm quote rule (*see* Exchange Rule 958A and Rule 11Ac1-1 under the Act, 17 CFR 240.11Ac1-1) 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

<sup>6</sup> Rule 155 is made applicable to options trading by Rule 950(a) and Rule 111 is made applicable by Rule 950(c).

<sup>7</sup> The Exchange recently implemented Quick Trade, an enhancement to the Amex Order File (AOF) and AODB, which automates in certain situations the process of allocating trades to participating registered options traders. *See* Securities Exchange Act Release No. 45974 (May 22, 2002) 67 FR 37886 (May 30, 2002).