

or dealer has communicated to the exchange, a revised quotation size;

(2) At the time an order to sell (buy) is presented, a responsible broker or dealer is in the process of effecting a transaction in such [class and/or] series of option, and immediately after the completion of such transaction it communicates to the Exchange a revised quotation size, such responsible broker or dealer shall not be obligated by paragraph (c)(i) of this Rule to sell (buy) that option in an amount greater than such revised quotation size;

(3) Before the order sought to be executed is presented, a responsible broker or dealer has communicated to the Exchange a revised bid or offer; or

(4) At the time the order sought to be executed is presented, a responsible broker or dealer is in the process of effecting a transaction in such [class and/or] series of option, and, immediately after the completion of such transaction, a responsible broker or dealer communicates to the exchange a revised bid or offer; provided, however, that the responsible broker or dealer shall nonetheless be obligated to execute any such order as provided in paragraph (c)(i) at its revised bid or offer in any amount up to its published quotation size or revised quotation size; or

(B) No change.

(d) No change.

\* \* \* \* \*

## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Amex included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Amex has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

In November 2000, the Commission determined to impose market-wide firm quote obligations on the options markets effective April 1, 2001.<sup>3</sup> Rule 11Ac1-1 under the Act (known as the Quote Rule) requires all national securities

exchanges to establish procedures for collecting from their members and making available to quotation vendors, bids, offers and quotation sizes with respect to reported securities. It also requires that quotation information be "firm" for the disseminated size, subject to certain exceptions. In applying the Quote Rule to the options markets, the SEC required the options exchanges to amend their rules to conform to the requirements of the Quote Rule. The Amex amended Rule 958A as required and received final SEC approval of the amendments in June 2001.<sup>4</sup>

The purpose of the Quote Rule is to make information on prices, volume and quotes for securities in all markets available to all investors so that they can make informed investment decisions. However, the SEC also recognized that the rule needs to prevent responsible brokers or dealers from being required to execute more than one order on the basis of the disseminated bid or offer and that the responsible brokers or dealers need sufficient time to update their quotations following completion of a transaction. Thus, in conforming Amex Rule 958A to the Quote Rule, the Amex included two exceptions, among others, from SEC Rule 11Ac1-1, with revisions to clarify the manner in which the Amex planned to interpret and enforce the Quote Rule in its options market.

The Quote Rule exceptions provide that the specialist would be relieved of his obligation to effect transactions at his published bid or published offer if (i) before an order is presented for execution, the specialist has communicated to the Exchange a revised bid or offer superseding his published bid or offer (a "revised bid or offer") or, (ii) at the time an order is presented, the specialist is in the process of effecting a transaction in that security, and, immediately after the completion of such transaction, he communicates a revised bid or offer to the Exchange.<sup>5</sup>

The exceptions to the Quote Rule as set forth in Rule 11Ac1-1(c)(3) apply to "subject security" and it was unclear at the time the Amex amended Rule 958A whether the exceptions applied to an option class, option series or both. The

definition of subject security found in Rule 11Ac1-1 suggests both.<sup>6</sup> As a result, in order to clarify its understanding of the scope of the exceptions, the Amex specified in its amendment to Rule 958A that the exceptions would apply to the entire class as well as each individual series in an option class. Thus, pursuant to the exceptions set forth in Amex Rule 958A(c)(ii), the specialist and registered options traders, as responsible brokers or dealers, are not required to execute more than one order at their published bid or offer in that series or in any series within that option class. The period of time within which the specialist and registered options traders are relieved of their obligation to effect additional transactions at the published bid or offer would begin to run for all series in a given option class whenever a transaction was being effected in any one of the series in that option class.

The Exchange believed at the time it filed its amendments to Rule 958A and continues to believe that the exceptions should apply to the entire class as well as each individual series in a given option class. It is appropriate to allow the exceptions to apply to the entire class as an effective way for specialists and registered options traders to manage their overall risk in an option class. In determining competitive quotes and sizes for each series, specialists and registered options traders take into consideration their overall risk in the option class. If there is a change in the price of the underlying stock or an execution in one series, the specialist and registered options trader will seek to re-quote all series in that class. The exceptions provide specialists with the ability to update quotes on a timely basis without having to be firm to multiple orders in different series within the same class submitted simultaneously by one or more market participants. Given the numerous series within each option class that are traded by the Exchange,<sup>7</sup> the requirements for specialists to make two-sided markets

<sup>6</sup> The term subject security is defined in subparagraph (a)(25) of Rule 11Ac1-1 as an "exchange-traded security" meeting certain executed volume thresholds. An "exchange-traded security" is defined in subparagraph (a)(10) as any "covered security" or "class of covered securities" listed or registered on an exchange. A "covered security" is defined in subparagraph (a)(6) and means any "reported security," which is defined in subparagraph (a)(20) and means any security or class of securities.

<sup>7</sup> For a typical equity option class, the Exchange initially lists 24 series, that is, both puts and calls in four expiration months with three strike prices within each expiration month. As the underlying stock price moves, additional series are added. Options on volatile stocks can have well over 100 different series trading at any given time.

<sup>3</sup> See Securities Exchange Act Release No. 43591 (November 17, 2000), 65 FR 75450 (December 1, 2000).

<sup>4</sup> See Securities Exchange Act Release No. 44383 (June 1, 2001), 66 FR 30959 (June 8, 2001).

<sup>5</sup> In the Quote Rule adopting Release the SEC further clarified the second exception by stating "[a] responsible broker or dealer should be deemed to be in the process of effecting a transaction from the moment an order is presented to him for execution until the completion of communication of all information necessary to complete the transaction." See Securities Exchange Act Release No. 14415 (January 26, 1978), 43 FR 4342 (February 1, 1978), at footnote 33.