

aggregate quotation size for less than ten (10) contracts.”

In applying the Quote Rule to the options markets, the Commission has given the options exchanges the flexibility to determine whether they will collect from responsible brokers or dealers and make available to quotation vendors the size associated with each quotation or choose instead to establish by rule the size for which their disseminated bid and offer in each option series is firm and not collect and disseminate size with each quotation. The Commission has also given the options exchanges the flexibility to disseminate quotations with sizes at which the specialist and registered traders are firm for customer accounts, and, at the same time, establish by rule a different size for which specialists and registered traders must be firm for orders from the accounts of broker-dealers.

As indicated above, the Amex previously determined that it would disseminate a size of ten (10) contracts for all of its option quotations regardless of the underlying “actual” size associated with such quote. In connection with the dissemination of option quotations, the Exchange amended and received Commission approval of Exchange Rule 958A requiring that the communicated and disseminated size be a minimum of ten (10) contracts. Therefore, responsible brokers or dealers on the Amex are required to disseminate a minimum size of ten (10) contracts for all options quotations regardless of whether such quotations may represent a customer or broker-dealer order.

The operation of Exchange Rule 958A in paragraph (c)(i)(A) requires that each responsible broker or dealer execute customer orders in an option series in an amount up to its published quotation size. As a result, specialists and registered options traders (“ROTs”) are required to be firm for customer orders of up to 10 contracts regardless of the actual size of the customer order. Paragraph (c)(i)(B) of Exchange Rule 958A provides that specialists and ROTs are obligated to be firm for the account of broker-dealer orders, including foreign broker-dealers, for at least one (1) contract.

The effect of the instant proposal will be that if a customer limit order representing the BBO is for less than ten (10) contracts, the Exchange would no longer disseminate a minimum size of ten (10) contracts, but instead, would disseminate the actual size of the customer limit order(s). As a result, the responsible broker or dealer would not be required to execute a minimum size

of ten (10) contracts for a customer order in cases where the disseminated quote is represented by a customer limit order of less than ten (10) contracts.

Therefore, under the proposed amendment to Exchange Rule 958A, the responsible broker or dealer will now be firm to customers for less than ten (10) contracts whenever the disseminated quote represents customer limit orders of less than ten (10) contracts.⁹ The proposed rule change also provides for a corresponding amendment to Commentary .01 to Exchange Rule 958A so that the specialist and ROT responsible for the published bid or offer is obligated for the size of the customer limit order on the book representing the BBO if less than ten (10) contracts in connection with an erroneous bid or offer that is the result of an error or omission by the Exchange or a quotation vendor.

For purposes of the application of the Options Intermarket Linkage (the “Linkage”), the Amex represents that the proposal will not affect the Exchange’s Linkage Rules. In particular, “Firm Customer Quote Size”¹⁰ and “Firm Principal Quote Size”¹¹ as defined in Exchange Rule 940 will not be revised without amendment to the Linkage Plan by all options exchanges and approval by the Commission. The obligation of the specialist to execute at

⁹ An example of the Rule’s current operation is as follows: An Exchange specialist disseminates a market of 2 bid, 2.20 asked, in a particular option series at the minimum size of 10 contracts. An incoming order to buy one contract for 2.10 is entered making the new best bid and offer 2.10 bid, 2.20 asked. The Exchange disseminates 10 contracts as the size of the 2.10 bid. If a market order to sell 10 contracts is then entered in that series, the responsible broker-dealer (generally the specialist) is obligated to buy the 9 contracts at a price of 2.10. The risk of requiring a size of ten (10) contracts to be disseminated is that the specialist is discouraged from increasing guaranteed sizes because of the greater potential liability. This proposal accordingly seeks to reduce this exposure by disseminating the actual size of customer limit orders representing the BBO if less than ten (10) contracts so that the responsible broker or dealer is not obligated to buy the balance between the actual size and the guaranteed size.

¹⁰ Exchange Rule 940(b)(7) defines “Firm Customer Quote Size” as the lesser of: (a) The number of option contracts that the Participant Exchange sending a P/A Order guarantees it will automatically execute at its disseminated quotation in a series of an Eligible Option Class for Public Customer orders entered directly for execution in that market; or (b) the number of option contracts that the Participant Exchange receiving a P/A Order guarantees it will automatically execute at its disseminated quotation in a series of an Eligible Option Class for Public Customer orders entered directly for execution in that market. The number shall be at least 10.

¹¹ Exchange Rule 940(b)(8) defines “Firm Principal Quote Size” as the number of options contracts that a Participant Exchange guarantees it will execute at its disseminated quotation for incoming Principal Orders in an Eligible Option Class. This number shall be at least 10.

least a size of ten (10) contracts for Linkage Orders will be unchanged by the adoption of this proposal.¹² With respect to automatic executions (“Auto-Ex”) outside of Linkage, the proposed change will not affect the current minimum Auto-Ex size of ten (10) contracts. Accordingly, orders that are not Auto-Ex eligible¹³ or are subject to an exception in Exchange Rule 933(f), will be manually handled by the specialist and will receive an execution size of up to the disseminated size of the quoted market.

The Exchange believes that the instant proposal to revise the operation of Exchange Rule 958A so that customer limit orders representing the best bid or offer are disseminated in actual size if less than ten (10) contracts should provide greater transparency to investors and the marketplace because the actual size of orders will be disclosed rather than an artificial minimum size. In addition, the Amex further believes that the proposal to disseminate the actual size of booked customer limit orders representing the BBO will better reflect the true state of liquidity. The Exchange notes, that as a result of the proposed rule change, the responsible broker or dealer would be permitted to disseminate a size of less than ten (10) contracts when the BBO is reflected by customer limit orders. Currently, the responsible broker or dealer is required to disseminate a size of at least ten (10) contracts in all circumstances.

The Exchange submits that the adoption of this proposal will foster increased competition by the Amex against markets that disseminate quotes with actual size. The Auto-Ex system at the Amex available for both customer and broker-dealer orders would not be impacted by this proposal.¹⁴ In

¹² See Securities Exchange Act Release Nos. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (Original Linkage Plan Approval); 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001) (Plan Amendment No. 1 Approval); 46001 (May 30, 2002), 67 FR 38687 (June 5, 2002) (Plan Amendments Nos. 2 and 3 Approval); 47298 (January 31, 2003), 68 FR 6524 (February 7, 2003) (Plan Amendment No. 4 Approval); 47274 (January 29, 2003), 68 FR 5313 (February 3, 2003) (Plan Amendment No. 5 Approval); and 47297 (January 31, 2003), 68 FR 6526 (February 7, 2003) (Approval of Amex Linkage Rules).

¹³ The minimum eligible Auto-Ex size is ten (10) contracts while the maximum eligible Auto-Ex size is determined by the Exchange subject to a 500 contract ceiling (except in the case of options on QQQs which may be 2,000 contracts for the two near term months and 1,000 contracts for all other months).

¹⁴ See Securities Exchange Act Release Nos. 22610 (November 8, 1985), 50 FR 47480 (November 18, 1985) (pilot program for XMI options); 23544 (August 20, 1986), 51 FR 30601 (August 27, 1986)