

to add new Section VII entitled "Broker-Dealer Auto-Ex Fee" to the Options Fee Schedule for the purpose of adopting a \$0.50 transaction fee per contract side for all broker-dealer orders<sup>7</sup> executed via the Exchange's automatic execution system ("Auto-Ex").<sup>8</sup> Broker-dealer orders executed through Auto-Ex would also be subject to the Exchange's existing options comparison fee and options floor brokerage fee. For firms and broker-dealers, the comparison fee and floor brokerage fee is \$0.04 and \$0.03 per contract side, respectively, while for specialists and market makers these charges per contract side are each \$0.05.

The Exchange represents that broker-dealer orders subject to the proposed fee, include without limitation, firm orders, specialist orders, market maker orders and orders for the account of registered broker-dealers. The Amex notes that it will only charge this fee to member firms through the customary monthly billing that occurs shortly after the close of each trading month. The Amex represents that non-members will not be subject to this proposed fee. Accordingly, the Amex will assess this fee solely against firms executing orders for the accounts of broker-dealers.

Broker-dealers who want to access the Exchange's markets without paying this additional fee may continue to send their orders to a floor broker for manual execution. However, broker-dealer orders that are automatically executed through Auto-Ex are not subject to fees otherwise imposed by an Amex floor broker in connection with a manual execution. The Amex believes that the benefits of automatic execution outweigh the potential burden of paying the proposed fee.

The Exchange submits that the proposed fee will provide additional revenue and recoup the costs associated with permitting the automatic execution of broker-dealer orders. In addition, the Amex submits that this fee will help to allocate to broker-dealer orders a fair share of the related costs of operating Auto-Ex and related Exchange systems. The Exchange further asserts that

permitting the Auto-Ex system to accept and execute broker-dealer orders requires design modification, programming and testing. Accordingly, the Exchange believes that the proposed fee is reasonable.

## 2. Statutory Basis

The Exchange believes the proposed rule change, as amended, is consistent with Section 6(b) of the Act,<sup>9</sup> in general, and with Section 6(b)(4)<sup>10</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees, and other charges among its members.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change establishes or changes a due, fee, or other charge and, therefore, has become effective immediately pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>11</sup> and Rule 19b-4(f)(2) thereunder.<sup>12</sup> At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of the Act.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written

communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-2002-114 and should be submitted by February 21, 2003.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47229; File No. SR-Amex-00-30]

### Self-Regulatory Organizations; Notice of Filing of Amendments to Proposed Rule Change by the American Stock Exchange LLC Relating to the Allocation of and Participation in Options Trades

January 22, 2003.

On May 30, 2000, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change relating to the allocation of and participation in options trades on the Exchange. The proposed rule change was published for comment in the **Federal Register** on June 28, 2000.<sup>3</sup> On August 25, 2000, August 30, 2001, February 19, 2002, April 22, 2002, September 16, 2002, and December 20, 2002, respectively, the Amex filed Amendment Nos. 1, 2, 3, 4, 5, and 6 to the proposed rule change.<sup>4</sup>

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 42964 (June 20, 2000), 65 FR 39972 (June 28, 2000).

<sup>4</sup> See letters from Claire P. McGrath, Vice President and Special Counsel, Amex, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated August 24, 2000 (Amendment No. 1) and August 29, 2001 (Amendment No. 2); and from Claire P. McGrath, Senior Vice President and Deputy General Counsel, Amex, to Elizabeth King, Associate Director, Division, Commission, dated February 15, 2002 (Amendment No. 3), April 22, 2002 (Amendment

2002), 67 FR 37888 (May 30, 2002) (SR-CBOE-2002-22) (CBOE six-month pilot program permitting broker-dealer orders for QQQ options to be Executed on RAES); and 46113 (June 25, 2002), 67 FR 44486 (SR-CBOE-2002-35) (July 2, 2002) (extending CBOE pilot to all index products).

<sup>7</sup> A broker-dealer order is an order for the account of a registered broker-dealer.

<sup>8</sup> The Commission has approved the adoption of broker-dealer automatic execution fees for other options exchanges. See Securities Exchange Act Release Nos. 45662 (March 27, 2001), 67 FR 16786 (April 8, 2002) (SR-PCX-2002-10); 46212 (July 16, 2002), 67 FR 48235 (July 23, 2002) (SR-Phlx-2002-36); and 46455 (September 3, 2002), 67 FR 57468 (September 10, 2002) (SR-CBOE-2002-42).

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(4).

<sup>11</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>12</sup> 17 CFR 240.19b-4(f)(2).

The proposed rule change, in its amended version, is described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Amex proposes to codify in Rule 933(d), Rule 950(d), Commentary .06, and Rule 950(n), Commentary .03 current practices regarding the participation in option trades executed on the Exchange by registered options traders and specialists and the allocation of those trades to the appropriate party. The text of the proposed rule change is set forth below. Deleted language is in brackets. Proposed new language is *italicized*.

\* \* \* \* \*

#### Rule 933 Automatic Execution of Options Orders

(a)–(c) No change.

(d) *Options orders executed through Auto-Ex shall be automatically allocated on a rotating basis to the specialist and to each trader that has signed on to Auto-Ex. Auto-Ex trades of ten contracts or less are allocated to each Auto-Ex participant as set forth below. If an Auto-Ex trade is greater than ten contracts, the Auto-Ex system divides the execution into lots of ten or fewer contracts and allocates a lot to each Auto-Ex participant. Each lot is considered a separate trade for purposes of allocating trades within Auto-Ex. The rotation is designed to provide that the allocation of Auto-Ex trades between the specialist and*

*traders signed on to Auto-Ex in a given option class is as follows:*

<i>Number of traders signed on to Auto-Ex</i>	<i>Approximate number of trades allocated to the specialist (percent)</i>	<i>Approximate number of trades allocated to the traders signed on to Auto-Ex (as a group) (percent)</i>
1 .....	60	40
2–4 .....	40	60
5–7 .....	30	70
8–15 .....	25	75
16 or more	20	80

\* \* \* Commentary

.01–.02 No change.

\* \* \* \* \*

#### Rules of General Applicability

##### Rule 950

(a)–(c) No change.

(d) The provisions of Rule 126, with the exception of subparagraphs (a) and (b) thereof, shall apply to Exchange option transactions and the following additional commentary shall also apply.

\* \* \* Commentary

.01–.05 No change.

.06 (i) *When two or more bids (offers) are made simultaneously by the specialist dealing for his own account and by registered options traders, all such bids (offers) shall be on parity and any contracts sold (bought) in execution of such bids (offers) shall be divided among the specialist and registered options trader(s) so that the specialist shall receive the following percentage of contracts executed and the registered options traders shall divide the remainder in accordance with Rule 950(n), Commentary .03(a)(iii):*

<i>Number of traders on parity</i>	<i>Approximate number of contracts allocated to the specialist (percent)</i>	<i>Approximate number of contracts allocated to the traders (as a group) (percent)</i>
1 .....	60	40
2–4 .....	40	60
5–7 .....	30	70
8–15 .....	25	75
16 or more	20	80

*Notwithstanding the foregoing, neither the specialist nor a registered options trader will be allocated more executed contracts than the number of contracts representing the specialist's or registered options trader's portion of the aggregate quotation size, as that term is used in Rule 958A, except, when the number of executed contracts to be allocated exceeds the aggregate*

*quotation size disseminated for that options series.*

(ii) *The above provision applies only when the specialist and registered options trader(s) are on parity and does not include situations where a customer order is also on parity with the specialist and registered options traders. When a customer is on parity with the specialist and registered options traders, the specialist will allocate executed contracts (1) to the customer and to those registered options traders or specialist on parity with the customer on an equal basis subject to Rule 950(n), Commentary .03(a)(v); and then (2) to the specialist and the registered options traders in accordance with Rule 950(n), Commentary .03(a)(iii). The following rules set forth provisions regarding priority and parity of registered options traders and specialists when customer orders are involved: Rule 111, Commentary .07, which is made applicable to options trading by Rule 950(c), provides that registered options traders in establishing or increasing a position may not retain priority over or have parity with a customer order, and Rule 155, which is made applicable to options trading by Rule 950(a), 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.*

(e)–(m) No change.

(n) The provisions of Rule 170 and Commentaries .03 and .04 thereto, shall apply to [e]Exchange option transactions. In addition, the following Commentary shall also apply:

\* \* \* Commentary

[.10] .01 A specialist in the course of maintaining a fair and orderly market shall adhere to the maximum permissible bid/ask differentials set forth in Rule 958(c).

.02 No change.

.03 (a) *It is the responsibility of the specialist to allocate executed contracts among all participants to a trade.*

(i) *In order for specialists to fulfill this function, registered options traders must 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 each option series in which they are willing to participate. The specialist may not assume a size for any registered options trader and only those registered options traders that have announced their sizes as discussed above will be allocated any executed contracts.*

(ii) *The registered options traders announced sizes shall be promptly*

No. 4), September 13, 2002 (Amendment No. 5), and December 19, 2002 (Amendment No. 6).

Amendment No. 1 added proposed rule text concerning the allocation of an incoming order when a customer is on parity with the specialist and registered options traders. Amendment No. 2 provided further explanation of the interaction of existing and proposed rules in this situation. Amendment Nos. 03, 4, and 5 further clarified how options trades on the Exchange are allocated, and were submitted by Amex in compliance with Section IV.B.j. of the Commission's Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, Securities Exchange Act Release No. 43268 (September 11, 2000) ("Order"). Section IV.B.j. of the Order requires that respondent options exchanges adopt new, or amend existing, rules to set forth any practice or procedure "whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option class, or the allocation of orders in that option class." Amendment No. 6 made minor modifications and non-substantive changes to the proposal.

communicated to the Exchange as required by Rule 958A(c)(i).

(iii) As transactions occur the specialist shall allocate to the extent mathematically possible (A) the portion of the executed contracts that the customer is entitled to and the portion of the executed contracts to those on parity with the customer on an equal basis subject to subparagraph (v) of this paragraph (a); (B) the portion of the executed contracts that the specialist is entitled to pursuant to the participation percentages set forth in Rule 950(d), Commentary .06; and then (C) the portion of the executed contracts participating registered options traders are entitled to individually. The

allocation pursuant to (C) is subject to the following provisions:

1. where all participants have equal stated sizes, their participations shall be equal;

2. where participants' stated sizes are not equal, their participations will depend upon whether the number of executed contracts left to be allocated exceeds the participants' aggregate stated sizes;

3. if the number of executed contracts left to be allocated does not exceed the participants' aggregate stated sizes, the specialist will allocate the executed contracts equally, unless a participant's stated size is for an amount less than an equal allocation, then the smallest sizes

will be allocated first, until the number of executed contracts remaining to be allocated requires an equal allocation.

4. if the number of executed contracts left to be allocated does exceed the participants' aggregate stated sizes, the specialist will allocate the executed contracts by first allocating to each participant the number of executed contracts equal to each participant's stated size with the remainder being allocated based on the percentage a participant's stated size is of the participants' aggregate stated size.

5. The following chart illustrates how different numbers of executed contracts will be allocated to participants whose aggregate stated size is 100 contracts:

NUMBER OF EXECUTED CONTRACTS TO BE ALLOCATED

Each participant's stated size	200	90	70	50
50 .....	100	40	25	17
30 .....	60	30	25	17
20 .....	40	20	20	16

(iv) In the event a specialist or registered options trader declines to accept any portion of the available contracts, any remaining contracts shall be apportioned among the remaining participants who bid or offered at the best price at the time the market was established in accordance paragraph (iii) above, until all contracts have been allocated.

(v) Specialists may direct some or all of their participation amount to competing public orders in the trading crowd.

(b) Notwithstanding the foregoing, when the transaction occurs without the participation of the specialist (either as principal or agent), the floor broker representing the contra-side of the trade shall distribute the executed contracts equally among the participating registered options traders, unless a registered options trader's portion of the disseminated size is less than an equal distribution. That registered options trader will be given a less than equal distribution and the remaining contracts will be allocated equally among the remaining participants to the trade. In addition, if neither the specialist nor a floor broker representing a customer is participating in the trade, the participating registered options traders shall allocate the executed contracts among themselves in accordance with subparagraph (a)(iii) above.

## 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, as amended, 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 Exchange 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 Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

Since the inception of options trading at the Exchange in 1975, both specialists and registered options traders ("traders") have had the responsibility of making markets in options. Exchange rules require that both specialists' and traders' transactions constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market and they should not enter into transactions or make bids or offers that are inconsistent with such a course of dealings. Specialists and traders shall engage, to a reasonable degree under the existing circumstances, in dealings for their own accounts when there exists a lack of price continuity, a temporary disparity

between the supply of and demand for option contracts of a particular series, or a temporary distortion of the price relationships between option contracts of the same class. As the Commission stated in its Order announcing the effectiveness of the Exchange's plan to list and trade options, the Amex's " \* \* \* registered floor traders will be expected to trade in a way that assists the specialist in maintaining a fair and orderly market \* \* \* " <sup>5</sup> (emphasis supplied). Specialists do, however, have additional obligations which include, among other things, the obligation to (1) assure that disseminated market quotations are accurate; (2) assure that each disseminated market quotation in appointed options classes is honored up to the disseminated size; (3) determine any formula for generating the automatically updated market quotations and disclosing the elements of that formula to the members of the trading crowd; (4) be present at the trading post throughout every business day; (5) participate at all times in the automated execution system for each assigned option class; and (6) resolve trading disputes, subject to Floor Official review upon the request of any party to the dispute.

In the course of making markets, specialists are often on parity with registered options traders, that is, bidding and offering simultaneously to provide liquidity. Generally, Exchange Rule 126 (made applicable to options

<sup>5</sup> See Securities Exchange Act Release No. 11144 (December 19, 1974), 40 FR 3258 (January 20, 1975).

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).

announce his size to the trading crowd, his size could be determined from the disseminated quote size.

The Exchange states that over the years, it, as well as registered options traders and specialists, have recognized that, given their role, specialists should be entitled to a greater than equal share when on parity with registered options traders. As a result, a practice has developed in Amex trading crowds for many option classes to give the specialist a greater than equal share when on parity with registered options traders. The Exchange now seeks to codify this practice.

The Exchange believes that it is appropriate to provide a greater participation to specialists because they have responsibilities that registered options traders do not have. For example, they have a continuous obligation to the market; to update and disseminate quotes in all securities; to reflect all market interest in the displayed quotes; and to act as contra-party on Auto-Ex at all times.<sup>8</sup> In addition, specialists incur costs that registered options traders do not, such as the fixed staffing costs committed to market making in a particular option whether it is actively traded or not, and the costs associated with participating in educational and marketing functions to attract order flow. In order to attract to the Exchange specialist units that are willing to accept these responsibilities, the Amex believes that it is necessary to provide specialists with an enhanced participation. The Exchange also believes that it must provide these enhanced participations in order to be competitive with other options exchanges that currently offer enhanced participation to their specialists and primary market makers.<sup>9</sup> In the Exchange's view, the enhanced participation would also give specialists the ability to attract order flow to the Exchange and its customers with tighter, more competitive markets. The Exchange states that, as a result, it would be able to attract new specialist units and retain the services of existing units.

The adoption of Commentary .06 to Rule 950(d) would provide that a specialist's participation in the number of option contracts executed varies depending upon the number of traders on parity. The proposed distribution of option contracts between the specialist and the traders on parity is as follows:

Number of traders on parity	Approximate number of option contracts allocated to the specialist (percent)	Approximate number of option contracts allocated to the traders (as a group) (percent)
1	60	40
2-4	40	60
5-7	30	70
8-15	25	75
16 or more	20	80

It should be emphasized that the above percentages would apply only when the specialist and/or registered options traders are on parity and would not include situations where a customer order is also on parity with the specialist and registered options traders. It should be noted, however, that a specialist cannot be on parity with an order for which he is acting as agent, and registered options traders (who never act as agents and trade only for their own accounts) cannot be on parity with a customer when either establishing or increasing their position in the option. In such situations, as provided in proposed subparagraph (a)(iii)(A) of Commentary .03 to Rule 950(n), the specialist would first allocate executed contracts to the customer and to the specialist and/or those registered options traders on parity with the customer. Any contracts that remain would be allocated among the specialist and registered options traders in accordance with proposed subparagraph (a)(iii)(B) of Commentary .03 to Rule 950(n), which would provide that the specialist would receive a participation in the remaining contracts in accordance with the table set forth above and in proposed Commentary .06(i) to Rule 950(d).

In addition, as specified in Commentary .06(i) to Rule 950(d), neither the specialist nor a registered options trader would be allocated more executed contracts than the number of contracts representing the specialist's or registered options trader's portion of the aggregate quotation size that the responsible broker or dealer would be obligated to communicate to the Exchange pursuant to Exchange Rule 958A(c), except when the number of executed contracts to be allocated exceeded the aggregate quotation size disseminated for that options series. Thus, for the following two examples, assume that the aggregate quotation size is 100 contracts, the specialist's portion is 25 contracts and the registered options trader's portion is 75 contracts.

*First example.* An off-floor to sell 80 contracts is submitted for execution at the disseminated bid. Pursuant to the

chart set forth above, the specialist would be entitled to 60% of the executed contracts. The specialist, however, would only be allocated 25 executed contracts and the registered options trader would be allocated 55 executed contracts.

*Second example.* An off-floor order to sell 200 contracts is submitted for execution at the disseminated bid. The specialist and registered options trader would first be allocated 25 contracts and 75 contracts respectively, plus the specialist would receive 60% of the remaining 100 contracts for a total of 85 contracts, and the registered options trader would receive 40% for a total of 115 contracts.

Once the specialist determined his portion of the trade depending upon the number of traders on parity, he would deduct his portion and allocate the remaining contracts to the registered options traders based upon: (i) An equal distribution, as described in the first example below; (ii) filling the smallest size(s) first, as described in the second example below; (iii) a combination based on filling the smallest size first and equal distribution, as described in the third example below; or (iv) prorated based on the registered options traders' generally known sizes and the percentage those sizes represent of their aggregate disseminated size, as described in the fourth example below. The number of contracts in the incoming order would determine which of the methods would be used in the allocation.

Assume the following information for each of the following four examples: The disseminated bid for a particular option series has an aggregate size of 1,000 contracts. The specialist is bidding for 650 contracts, and four registered options traders' generally known sizes are as follows: Trader A—200 contracts; Trader B—100 contracts; Trader C—30 contracts; and Trader D—20 contracts. There are no customer orders participating in the bid.

*First example.* An off-floor order to sell 100 contracts is submitted for execution at the disseminated bid. The specialist would allocate the executed contracts as follows: The specialist would receive 40 contracts (or 40%), and would allocate the remaining executed contracts equally to each of the four traders 15 contracts (or 25% of the remaining 60 contracts).

*Second example.* An off-floor order to sell 500 contracts is submitted for execution at the disseminated bid. The executed contracts would be allocated by the specialist as follows: (i) The specialist would receive 40% (200 contracts) of the 500 executed contracts

<sup>8</sup> See also Amex Rule 26.

<sup>9</sup> See Chicago Board Options Exchange Rule 8.80; Pacific Exchange Rule 6.82, and Philadelphia Stock Exchange Rule 1014(g).

pursuant to the participation rates set forth above; and (ii) the remaining 60% (300 contracts) would be divided among the registered options traders based upon their generally known sizes with an attempt to completely fill the smallest size(s) first, which in this example would be 20 contracts for Trader D, 30 contracts for Trader C, and 100 contracts for Trader B. A total of 150 contracts would be deducted, leaving 150 contracts to be allocated to Trader A.

*Third example.* An off-floor order to sell 200 contracts is submitted for execution at the disseminated bid. The executed contracts would be allocated by the specialist as follows: (i) The specialist would receive 40% (80 contracts) of the 200 executed contracts pursuant to the participation rates set forth above; and (ii) the remaining 60% (120 contracts) would be divided among the registered options traders based upon their generally known sizes with an attempt to completely fill the smallest size(s) first and an equal distribution of any remainder. Thus, the smallest sizes would be filled first—20 contracts for Trader D and 30 contracts

for Trader C—and the remaining 110 contracts would be divided equally, with 55 contracts distributed each to Trader A and Trader B. Trader B would not receive 100 contracts (its generally known size) because such size would be more than an equal share of the remaining 110 contracts.

*Fourth example.* An off-floor order to sell 2,000 contracts is submitted for execution at the disseminated bid. Pursuant to the firm quote rule, the specialist and registered options traders, as the responsible broker or dealers, would be obligated to execute order(s) at the disseminated bid up to their disseminated size. The specialist and traders would be able to execute the first 1,000 contracts at the disseminated bid and execute the remaining contracts at a lower bid or bids. If, however, the specialist and registered options traders have determined, either individually or collectively (pursuant to Amex Rules 950(n), Commentary .02(b) and 958(h)(ii)), to execute the entire order at their disseminated bid, the executed contracts will be allocated as follows: (i) the specialist would receive 650 executed contracts representing his

portion of the aggregate quotation size, plus 40% of the remaining 1,000 executed contracts pursuant to the participation rates set forth above for a total of 1,050 executed contracts; and (ii) the remaining 950 contracts would be divided among the registered options traders proportionally based upon their generally known sizes, the aggregate of which, in this example is 350 contracts: Trader A would receive an allocation of approximately 542 contracts ( $200/350=57\%$  of the 950); Trader B would receive an allocation of approximately 275 contracts ( $100/350=29\%$  of the 950 contracts); Trader C would receive an allocation of approximately 81 contracts ( $30/350=8.5\%$  of the 950 contracts); and Trader D would receive an allocation of approximately 52 contracts ( $20/350=5.5\%$  of the 950 contracts).<sup>10</sup>

In addition, the proposed rule text sets forth a chart that illustrates how various numbers of executed contracts would be allocated to registered options traders after the specialist has allocated portions to the customer and to the specialist. In each example, the chart assumes the aggregate stated size is 100 contracts:

NUMBER OF EXECUTED CONTRACTS TO BE ALLOCATED

Each participant's stated size	200	90	70	50
50	100	40	25	17
30	60	30	25	17
20	40	20	20	16

The first column illustrates the situation when the number of executed contracts exceeded the registered options traders' aggregate stated size and each registered options trader had determined either individually or collectively to participate for a larger size. The rest of the columns illustrate situations when the number of executed contracts was less than the registered options traders' aggregate stated size: The second column illustrates the situation when two of the three registered options traders' smaller sizes would be filled first and the third registered options trader would be allocated the remainder; the third column illustrates the situation when only one registered options trader's smallest size would be filled and the remaining executed contracts would be allocated equally between the two

remaining registered options traders; and the fourth column illustrates the situation when all executed contracts would be allocated equally among the participating registered options traders.

The Exchange notes that the Commission staff has also asked whether a specialist or registered options trader can decline an allocation of executed contracts. As noted above, the firm quote rule requires specialists and registered options traders to be "firm" up to their disseminated size unless one of the exceptions set forth in the rule applies. If a specialist or registered options trader declined an allocation or "backed away" from his disseminated size in whole or in part, he would be in violation of the firm quote rule, investigated, and sanctioned accordingly. If the other participants to the disseminated quote size determined

to increase the size of their participation to cover for the declining specialist or registered options trader, the executed contracts would be allocated based upon the principles discussed above, that is, 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. Moreover, if the size of the incoming order was greater than the disseminated size and one or more registered options traders were not willing to participate in a size larger than their disseminated size, then the additional executed contracts would be allocated to the remaining participants based upon their participation rights as set forth in proposed Rule 950(d), Commentary .06 and the principles set forth in proposed Rule 950(n),

<sup>10</sup> The Commission notes that the allocation to each trader, calculated above as a percentage of 950 contracts, is essentially equivalent to the number of contracts each trader would receive by allocating the contracts as follows: First, each trader would receive his or her portion of the first 1000 contracts,

based on the size each trader was quoting. In addition to these contracts, each trader would receive a percentage of the 600 contracts that would remain out of the second 1000 contracts after the specialist's percentage of 40% was allocated. The percentage each trader would receive of those 600

contracts would be based on the percentage that that trader's quote had represented out of the 350 contracts that the traders were quoting in the aggregate originally.

Commentary .03 which sets forth the participation percentages allocated to the specialist and registered options traders based upon the number of registered options traders participating on the trade.

In addition, the Exchange proposes to codify in Rule 933(d) its procedures regarding the allocation of Auto-Ex executed options trades<sup>11</sup>, which are automatically allocated on a rotating basis to the specialist and to each trader that has signed on to Auto-Ex<sup>12</sup>. Auto-Ex trades of ten contracts or fewer would be allocated to each Auto-Ex participant as set forth below.

If an Auto-Ex trade is greater than ten contracts, the Auto-Ex system divides the execution into lots or ten or fewer contracts and allocates a lot to each Auto-Ex participant<sup>13</sup>. Each lot is considered a separate trade for purposes of allocating trades within Auto-Ex. The rotation is designed to provide that the allocation of Auto-Ex trades between the specialist and traders signed on to Auto-Ex in a given option class is as follows:

Number of trades signed on to auto-ex	Approximate number of trades allocated to the specialist throughout the day (percent)	Approximate number of traders allocated to the traders signed on to auto-ex throughout the day (as a group)
1 .....	60	40
2-4 .....	40	60
5-7 .....	30	70
8-15 .....	25	75
16 or more .....	20	80

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act<sup>14</sup> in general and furthers the objectives of Section 6(b)(5) of the Act<sup>15</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged

in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change, as amended, will impose any burden on competition.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change or the amendments.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) By order approve such proposed rule change, or
- (B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal offices of the Amex. All submissions should refer to File No. SR-Amex-00-30 and should be submitted by February 21, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 03-2292 Filed 1-30-03; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47243; File No. SR-ISE-2003-01]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by International Securities Exchange, Inc., Relating to Fee Changes

January 24, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 9, 2003, the International Securities Exchange, Inc. ("Exchange" or "ISE") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in items I, II, and III below, which items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to establish a \$.10 surcharge for non-public customer transactions<sup>3</sup> in options on Select Sector SPDR Funds.

#### 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 Exchange 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 Exchange has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>15</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Telephone conversation between Joseph W. Ferraro, Assistant General Counsel, ISE, and Jennifer Colihan, Special Counsel, Division of Market Regulation ("Division"), Commission, January 16, 2003.

<sup>11</sup> Auto-Ex automatically executes public customer market and marketable limit orders of a minimum of 10 and a maximum of 500 option contracts or less. Both the specialist and registered options traders are contra-parties to the trades executed on the Auto-Ex system.

<sup>12</sup> At the start of each trading day, the order in which trades are allocated to the specialist and traders signed on to Auto-Ex is randomly determined.

<sup>13</sup> For example, an option class that allows up to 50 contracts to be executed through Auto-Ex would have a trade of 25 contracts divided into lots of 10, 10 and 5.

<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 15 U.S.C. 78f(b)(5).