

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48957; File No. SR-Amex-2003-24]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 3 by the American Stock Exchange LLC Relating to the Dissemination of Customer Limit Orders

December 18, 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 April 4, 2003, the American Stock Exchange LLC (“Amex” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On May 14, 2003, the Exchange filed Amendment No. 1 to the proposal.<sup>3</sup> On June 12, 2003, the Exchange filed Amendment No. 2 to the proposal.<sup>4</sup> The Commission published the proposal, as amended, for comment in the **Federal Register** on June 26, 2003.<sup>5</sup> The Commission received no comments on the proposal. On December 4, 2003, the Exchange filed Amendment No. 3 to the proposal.<sup>6</sup> In Amendment No. 3, the Amex proposes to replace the proposed rule change as set forth in the original notice in its entirety. The Commission is publishing this notice of Amendment No. 3 to solicit comments on the proposed rule change, as amended, from interested persons and to approve the proposal, as amended, on an accelerated basis.

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

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

<sup>3</sup> See letter from Jeffrey P. Burns, Associate General Counsel, Amex, to Nancy Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated May 12, 2003 (“Amendment No. 1”).

<sup>4</sup> See letter from Jeffrey P. Burns, Associate General Counsel, Amex, to Nancy Sanow, Assistant Director, Division, Commission, dated June 11, 2003 (“Amendment No. 2”).

<sup>5</sup> Securities Exchange Act Release No. 48101 (June 26, 2003), 68 FR 39992 (July 3, 2003) (“Original Notice”).

<sup>6</sup> See letter from Jeffrey P. Burns, Associate General Counsel, Amex, to Nancy Sanow, Assistant Director, Division, Commission, dated December 3, 2003 (“Amendment No. 3”). In Amendment No. 3, the Exchange proposes to modify the text of the rule proposal so that customer limit orders representing the best bid or offer are disseminated in actual size if less than ten (10) contracts.

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

The Exchange proposes to permit the dissemination of customer limit orders representing the best bid or offer (“BBO”) in sizes of less than ten (10) contracts. Below is the text of the proposed rule change as modified by Amendment No. 3. Proposed new language is italicized; proposed deletions are in brackets.

\* \* \* \* \*

#### Rule 958A. Application of the Firm Quote Rule

(a) No Change  
 (b) No Change  
 (c) Obligations of a Responsible Broker or Dealer—  
 (i) Pursuant to SEC Rule 11Ac1-1 each responsible broker or dealer for each series of each listed option class shall promptly communicate to the Exchange its best bid, best offer, quotation size and aggregate quotation size. No responsible broker or dealer shall communicate a quotation size or aggregate quotation size for less than ten contracts *with the exception that the size of customer limit orders representing the best bid or offer may be disseminated at less than ten (10) contracts, even though the responsible broker or dealer continues to have the obligation to quote a ten contract minimum.* This obligation may be fulfilled by the use of an automated quotation system.

(A) Subject to the provisions of paragraph (d) of this rule, each responsible broker or dealer shall be obligated to execute any customer order in an option series in an amount up to its published quotation size.

(B) Subject to the provisions of paragraph (d) of this rule, each responsible broker or dealer shall be obligated to execute any order for the account of a U.S. registered or foreign broker or dealer in a listed option in an amount up to the quotation size established and periodically published by the Exchange which quotation size shall be for at least one contract.

(C) Subject to the provisions of paragraph (d) of this Rule, each responsible broker or dealer shall comply with the Thirty Second Response provisions set forth in paragraph (d)(3) of SEC Rule 11Ac1-1.

(ii) No Change  
 (d) No Change

#### Commentary

.01 No specialist or registered options trader shall be deemed to be a responsible broker or dealer with

respect to a published bid or offer that is erroneous as a result of an error or omission made by the Exchange or any quotation vendor. If a published bid or published offer is accurate but the published quotation size (or published aggregate quotation size, as the case may be) associated with it is erroneous as a result of an error or omission made by the Exchange or any quotation vendor, then the specialist and registered options traders responsible for the published bid or published offer shall be obligated as set forth in paragraph (c) of Rule 11Ac1-1 but only to the extent of ten contracts *or in cases where the best bid or offer is represented by a customer limit order the actual size of such order(s) if less than ten contracts.*

.02 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 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 III 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

In 2001, the Exchange amended the firm quote requirement in Exchange Rule 958A to accommodate the application of the SEC Rule 11Ac1-1 (the “Quote Rule”) under the Act.<sup>7</sup> The amendments to the Commission’s Quote Rule in 2000 were made to apply the firm quote requirements to the option exchanges and option market makers, thereby, requiring a corresponding revision to the rules of the options exchanges.<sup>8</sup> At that time, the Amex proposed in Exchange Rule 958A that “no responsible broker or dealer shall communicate a quotation size or

<sup>7</sup> 17 CFR 240.11Ac1-1; see Securities Exchange Act Release Nos. 44145 (April 2, 2001), 66 FR 18662 (April 10, 2001) (notice) and 44383 (June 1, 2001), 66 FR 30959 (June 8, 2001) (approval of File Nos. SR-Amex-2001-18; SR-CBOE-2001-15; SR-ISE-2001-07; SR-6PCX-2001-18; and SR-Phlx-2001-37).

<sup>8</sup> See Securities Exchange Act Release No. 43591 (November 17, 2000), 65 FR 75439 (December 1, 2000).

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.<sup>9</sup> 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”<sup>10</sup> and “Firm Principal Quote Size”<sup>11</sup> 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

<sup>9</sup> 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.

<sup>10</sup> 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.

<sup>11</sup> 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.<sup>12</sup> 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 eligible<sup>13</sup> 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.<sup>14</sup> In

<sup>12</sup> 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).

<sup>13</sup> 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).

<sup>14</sup> 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)

addition, the dissemination of the actual size of customer limit orders representing the BBO should also enable specialists and ROTs to better manage their risks by enabling such specialists and/or ROTs to reflect the size in quotes based on market factors rather than regulatory requirements. The Amex seeks through this proposal to match other option exchanges that currently are able to disseminate actual size market quotations for customer orders.<sup>15</sup> The Exchange believes that this should lead to increased competition on the basis of size among the options exchanges, enabling investors to receive better executions.

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with section 6(b) of the Act<sup>16</sup> in general, and furthers the objectives of section 6(b)(5)<sup>17</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 will result in any burden on competition.

(permanent approval of XMI pilot); 24714 (July 17, 1987), 52 FR 28396 (July 29, 1987) (expansion to competitively traded options); and 46479 (September 10, 2002), 67 FR 58654 (September 17, 2002) (automatic execution of broker-dealer option orders). Auto-Ex is an automated execution system that enables member firms to route public customer market and limit orders in options for automatic execution at the bid or offer at the time the order is entered. Auto-Ex executes, at the displayed bid or offer, customer market and immediately executable limit option orders up to a specified number of contracts routed through the Common Message Switch ("CMS") and the Amex Order File ("AOF"). There are, however, some situations in which orders otherwise eligible for execution on Auto-Ex are routed to the specialist's book, known as the Amex Options Display Book or "AODB," for an execution. These situations occur when (i) the best bid or offer is represented by a limit order on the AODB, (ii) the best bid or offer is locked or crossed, (iii) there is a better bid or offer being displayed by a competing market, or (iv) when certain systems allowable parameters have been exceeded.

<sup>15</sup> See Securities Exchange Act Release Nos. 46325 (August 8, 2002), 67 FR 53376 (August 15, 2002) (File No. SR-Phlx-2002-15); 46029 (June 4, 2002), 67 FR 40362 (June 12, 2002) (File No. SR-PCX-2002-30); 45067 (November 16, 2001), 66 FR 58766 (November 23, 2001) (File No. SR-COE-2001-56); and 47959 (May 30, 2003), 68 FR 34441 (June 9, 2003) (File No. SR-CBOE-2002-05).

<sup>16</sup> 15 U.S.C. 78f(b).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

### 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. 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 by Amendment No. 3, 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. Comments should be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-Amex-2003-24. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, comments should be sent in hard copy or by e-mail but not by both methods. 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Amex-2003-24 and should be submitted by January 20, 2004.

## IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>18</sup> In particular, the Commission finds that the proposed rule change, as amended, is consistent with section 6(b)(5) of the Act, which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and

<sup>18</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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.<sup>19</sup> The Commission believes that the proposed rule change, as amended, should provide greater transparency to investors and the marketplace and should better reflect the true state of liquidity in the marketplace, because the actual size of customer limit orders representing the best bid or offer will be disclosed rather than an artificial minimum size. In addition, the Commission notes that the proposed rule change is consistent with the rules of other options exchanges.<sup>20</sup> Accordingly, the Commission finds good cause, pursuant to section 19(b)(2) of the Act,<sup>21</sup> for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**.

## V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (SR-Amex-2003-24), as amended, is hereby approved, and Amendment No. 3 is approved, on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,<sup>23</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48959; File No. SR-ISE-2003-38]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the International Securities Exchange, Inc. To Increase the Number of Authorized Shares of Class B Common Stock, Series B-2 from 130 to 160

December 18, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 11, 2003, the International Securities Exchange, Inc. ("Exchange" or "ISE") filed with the Securities and Exchange

<sup>19</sup> 15 U.S.C. 78f(b)(5).

<sup>20</sup> See *supra* note 15.

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</sup> *Id.*

<sup>23</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.