

increase the maximum AUTO-X order size eligibility for public customer market and marketable limit orders for all equity and index options from 25 contracts to 50 contracts. Under the proposal, 50 contracts represents the maximum size of a permissible AUTO-X order, which is determined by the specialist in that option. Consistent with the PHLX's 10-up rule,<sup>6</sup> the minimum size of the Exchange's AUTO-X guarantee is 10 contracts.

AUTOM, which has operated on a pilot basis since 1988 and was most recently extended through December 31, 1996,<sup>7</sup> is the PHLX's electronic order

routing, delivery, execution and reporting system for equity and index options. AUTOM is an online system that allows electronics delivery of options orders from member firms directly to the appropriate specialist on the Exchange's trading floor.

In 1990, AUTO-X was approved as part of the AUTOM pilot program.<sup>8</sup> AUTO-X orders are executed automatically at the disseminated quotation price on the Exchange and reported to the originating firm. Orders that are not eligible for AUTO-X are handled manually by the specialist.

The PHLX believes that the proposal should improve the AUTOM system by offering the benefits of AUTO-X, including prompt and efficient automatic executions at the displayed price, to additional customer orders. The Exchange states that the proposed AUTO-X increase from a maximum of 25 to 50 contracts is in line with prior changes. For example, the PHLX notes that the Commission previously has approved other PHLX proposals to increase the maximum AUTO-X contract size limit.<sup>9</sup>

Further, the Exchange believes that it is appropriate to permit automatic executions of option orders up to 50 contracts for several reasons. First, the PHLX states that AUTO-X orders, although immediately reported with the best bid/offer as the execution price, may be subject to price improvement by the specialist, if a better bid/offer is available. For example, a superior Registered Options Trader ("ROT") bid/offer established immediately prior to the receipt of an AUTO-X order may not be disseminated in time to be matched with the AUTO-X order electronically but the superior bid/offer may be matched with the AUTO-X order through manual intervention by the specialist.<sup>10</sup>

Second, the PHLX notes that Exchange rules and policies contain safeguards designed to protect customers, as well as ROTs and specialists, in the event quotations are not up-to-date, not disseminating, or otherwise malfunctioning. For example, in extraordinary (fast) market conditions, quotations are disseminated

with an "F" once the 10-up guarantee on screen markets is suspended pursuant to Option Floor Procedure Advice ("Advice") F-10, "Extraordinary Market Conditions (Fast Markets)." <sup>4</sup> In addition, Advice A-13, "Auto Execution Engagement/Disengagement Responsibility," allows a specialist to disengage AUTO-X in extraordinary circumstances, upon approval by two floor officials. The PHLX believes that these provisions serve to protect the integrity of AUTO-X by preventing inaccurate executions.

Third, the Exchange notes that specialists have the flexibility to establish the AUTO-X guarantee size for each option up to the maximum permissible size. In addition, the Exchange's "Wheel" for electronically assigning AUTO-X participation (although not yet operational) is voluntary for ROTs and will provide executions in 10-lot increments.<sup>12</sup> Thus, the PHLX believes that increasing the maximum AUTO-X order size up to 50 contracts does not raise financial viability concerns because ROTs can choose whether to participate on the Wheel and because the Wheel assigns orders in 10-lot increments. With respect to the financial integrity of PHLX specialists and ROTs, the Exchange notes that it monitors compliance with PHLX Rules 703, "Financial Responsibility and Reporting," and 722, "Margin Accounts," on a regular basis.

The PHLX believes that the proposal is consistent with Section 6(b) of the Act, in general, and, in particular, with Section 6(b)(5), in that it is designed to promote just and equitable principles of trade and to prevent fraudulent and manipulative acts and practices, as well as to protect investors and the public interests, by extending the benefits of AUTO-X to a larger number of customer orders.

The Commission finds that the proposed rule change is consistent with

<sup>11</sup> Under Advice F-10, when a fast market is in effect, displayed options quotes are not firm and the 10-up guarantee is not applicable, although specialists and trading crowds are required to use best efforts to update quotes and fill incoming orders in accordance with the 10-up rule.

<sup>12</sup> The Wheel is an automated mechanism for assigning specialists and ROTs, on a rotating basis, as contra-side participants for AUTO-X orders. Specialists must participate on the Wheel and ROTs may participate on the Wheel in assigned issues. On the Wheel, the specialist receives the first assignment of trades for the day in each respective option. Thereafter, the Wheel assigns trades to ROTs in an order standardized for that day on a random basis. Each 10 lot or order (whichever is smaller) constitutes an assignment. See Securities Exchange Act Release No. 35033 (November 30, 1994), 59 FR 63152 (December 7, 1994) (order approving File No. SR-PHLX-94-32).

1993) (order approving File No. SR-PHLX-92-38). For USTOP 100 Index ("TPX") options, public customer market and marketable limit orders for up to 50 contracts are eligible for AUTO-X. See Securities Exchange Act Release No. 35781 (May 30, 1995), 60 FR 30131 (June 7, 1995) (File No. SR-PHLX-95-29). Orders for up to 500 contracts are eligible for AUTOM. See Securities Exchange Act Release No. 35782 (May 30, 1995), 60 FR 30136 (June 7, 1995) (order approving File No. SR-PHLX-95-30).

<sup>6</sup> See PHLX Rule 1033(a), "Size of Bid/Offer and 10-up Guarantee."

<sup>7</sup> See Securities Exchange Act Release No. 36582 (December 13, 1995) (order approving File No. SR-PHLX-95-78). See also Securities Exchange Act Release Nos. 25540 (March 31, 1988), 53 FR 11390 (April 6, 1988) (order approving AUTOM on a pilot basis); 25868 (June 30, 1988), 53 FR 25563 (order approving File No. SR-PHLX-88-22, extending pilot through December 31, 1988); 26354 (December 13, 1988), 53 FR 51185 (order approving File No. SR-PHLX-88-33, extending pilot program through June 30, 1989); 26522 (February 3, 1989), 54 FR 6465 (order approving File No. SR-PHLX-89-1, extending pilot through December 31, 1989); 27599 (January 9, 1990), 55 FR 1751 (order approving File No. SR-PHLX-89-03, extending pilot through June 30, 1990); 28625 (July 26, 1990), 55 FR 31274 (order approving File No. SR-PHLX-90-16, extending pilot through December 31, 1990); 28978 (March 15, 1991), 56 FR 12050 (order approving File No. SR-PHLX-90-34, extending pilot through December 31, 1991); 29837 (October 18, 1991), 56 FR 36496 (order approving File No. SR-PHLX-90-03, extending pilot through December 31, 1993); and 33405 (December 30, 1993), 59 FR 790 (order approving File No. SR-PHLX-90-57, extending pilot through December 31, 1994); 35183 (December 30, 1994), 60 FR 2420 (January 9, 1995) (order approving File No. SR-PHLX-90-41, extending pilot through December 31, 1995); 29662 (September 9, 1991), 56 FR 46816 (order approving File No. SR-PHLX-91-31, permitting AUTO-X orders up to 20 contracts in Duracell options only); 29837 (October 18, 1991), 56 FR 55146 (October 24, 1991) (order approving File No. SR-PHLX-93-33, increasing AUTO-X for equity options to 20 contracts); 33405 (December 30, 1993), 59 FR 790 (order approving File No. SR-PHLX-93-57, extending pilot through December 31, 1994); 34920 (October 31, 1994), 59 FR 55510 (November 7, 1994) (File No. SR-PHLX-94-40, codifying use of AUTOM for index options); 35601 (April 13, 1995), 60 FR 19616 (File No. SR-PHLX-95-18, codifying the use of AUTOM for certain order types); 36429 (October 27, 1995), 60 FR 55874 (November 3, 1995) (File No. SR-PHLX-95-35, allowing broker-dealer USTOP 100 Index option orders to be routed through AUTOM); and 36467 (November 8, 1995), 60 FR 57615 (November 16, 1995) (order approving File No. SR-PHLX-95-33, limiting AUTO-X for National Over-the-Counter Index Options to series where the bid is \$10 or less).

<sup>8</sup> See Securities Exchange Act Release No. 27599 (January 9, 1990), 55 FR 1751 (January 18, 1990) (order approving File No. SR-PHLX-89-03). In 1991, the Commission approved a PHLX proposal to extend AUTO-X to all equity options. See Securities Exchange Act Release No. 28978 (March 15, 1991), 56 FR 12050 (March 21, 1991) (order approving File No. SR-PHLX-90-34).

<sup>9</sup> See, e.g., Securities Exchange Act Release No. 29837, *supra* note 7.

<sup>10</sup> But see note 14 and accompanying text regarding the provision of meaningful opportunity for price improvement.