

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55507 / March 22, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12594

In the Matter of

American Stock Exchange LLC,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS, A CENSURE,
AND A CEASE-AND-DESIST ORDER
PURSUANT TO SECTIONS 19(h)(1) AND
21C OF THE SECURITIES EXCHANGE
ACT OF 1934**

I.

The Securities and Exchange Commission (“Commission”) deems it necessary and appropriate in the public interest and for the protection of investors that public administrative and cease-and desist proceedings be, and hereby are, instituted pursuant to Sections 19(h)(1) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against the American Stock Exchange LLC (“Amex” or “Respondent”).

II.

In anticipation of the institution of these proceedings, the Amex has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over the Amex and the subject matter of these proceedings, which are admitted, the Amex consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, a Censure, and a Cease-and-Desist Order Pursuant to Sections 19(h)(1) and 21C of the Securities Exchange Act of 1934 (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. SUMMARY

This matter involves the failure by the Amex adequately to enforce certain order handling rules and to comply with its record keeping obligations. From at least 1999 through June 2004, the Amex had critical deficiencies in its surveillance, investigative, and enforcement programs for assuring compliance with its rules as well as the federal securities laws. The Amex did not conduct adequate surveillance for certain types of violations by its specialists and floor brokers. This was primarily because the Amex's surveillance programs were inadequate to detect such violations. When the surveillance programs detected possible order handling rule violations, the Amex did not adequately review the surveillance reports, investigate the potential violations reflected in those reports, or did not complete certain investigations in a timely manner. When the Amex did detect violations, it sometimes failed to make referrals for disciplinary action or improperly excused the conduct.

The Amex's continual regulatory deficiencies during this time period resulted in large part from its failures to pay adequate attention to regulation, to put in place an oversight structure, or to dedicate sufficient resources to ensure that the exchange was meeting its regulatory obligations. These failures were particularly significant with respect to the options market because the Amex was under a Commission order to improve its surveillance and enforcement of the options order handling rules. As a result of its failure adequately to surveil for and investigate violations of, and to enforce, certain options order handling rules, the Amex violated Section 19(g) of the Exchange Act. In addition, the Amex failed to furnish accurate records and, as a result, violated Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1.

In December 2004, the Amex was sold to its members, and in 2005, prior senior management was replaced. All of the conduct at issue occurred under prior senior management.

B. RESPONDENT

American Stock Exchange LLC, located in New York, New York, is a national securities exchange registered with the Commission pursuant to Section 6 of the Exchange Act. From 1998 until December 31, 2004, the Amex was a subsidiary of the National Association of Securities Dealers, Inc. ("NASD"). On December 31, 2004, the NASD completed the sale of its interest in the Amex and transferred control to the Amex Membership Corporation. New management has

¹ The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

assumed senior executive positions at the Amex, including the Chairman/Chief Executive Officer. The Amex trades over 800 stocks, various types of options, and over 100 exchange-traded funds.

C. FACTS

1. Prior Commission Action

From at least 1999, the Amex was on notice that its surveillance, investigatory, and enforcement programs were inadequate. On September 11, 2000, the Commission issued an order (“September 2000 Order”), to which the Amex consented, finding, in relevant part, that the Amex had failed effectively to enforce compliance by its members with exchange rules, policies, or procedures relating to options order handling.² Specifically, the Commission found that the Amex had failed to surveil for, or to take appropriate action with respect to evidence of, violations of firm quote,³ customer priority,⁴ limit order display,⁵ and trade reporting rules⁶. These rules were designed to protect investors and provide some of the primary safeguards against execution abuses by specialists.

² See In the Matter of Certain Activities of Options Exchanges, Exchange Act Rel. No. 43268 (Sept. 11, 2000). The Commission issued its order against the Amex and three other options exchanges.

³ The firm quote rule generally requires options specialists to trade options at the prices and in the amounts that they quote. During most of the period relevant to this Order, the firm quote rule for options was set forth in Exchange Act Rule 11Ac1-1, which had a compliance date of April 2001, and Amex Rule 958A. With the Commission’s adoption of Regulation NMS in August 2005, the Commission’s firm quote rule was redesignated as Exchange Act Rule 602. Under Exchange Act Rule 602, its predecessor Exchange Act Rule 11Ac1-1, and Amex Rule 958A, responsible brokers or dealers are required, with a few exceptions, to execute options transactions with customers at prices at least as favorable as their published bids or offers at the time the orders are presented and in any amount of contracts up to their published sizes.

⁴ With certain exceptions, the priority rules generally require that a customer limit order be executed prior to the execution of any other order if it has the best price, i.e., the highest bid or lowest offer. See Amex Rules 126 and 950(d). If there is more than one customer order at the best price, the customer order that arrives first has priority.

⁵ The obligation to display limit orders generally requires that a customer limit order that is priced better than the highest bid or the lowest ask price currently quoted on the exchange immediately be displayed in the quotations. As discussed infra at III.C.2.c., at the time of the September 2000 Order, specialists were required to display such limit orders as part of their due diligence obligations. In January 2005, the Commission approved, and the Amex thereafter implemented, a limit order display rule specifically applicable to options.

⁶ The trade reporting rule generally requires that transactions be reported within a specified time after execution. The Amex’s trade reporting rule, adopted in August 2000, requires that options transactions are to be reported to the Amex Options Market Data System within 90 seconds of execution and that transactions not reported within that time are to be designated as late. See Amex Rule 992.

The Commission ordered the Amex to enhance and improve its regulatory programs for surveillance, investigation, and enforcement of the options order handling rules, including compliance with the limit order display, priority, trade reporting, and firm quote rules. The Amex further was required to provide Commission staff with annual affirmations detailing its progress in complying with the September 2000 Order. The Amex failed to comply with these obligations.

2. Inadequate Surveillance, Investigatory, and Enforcement Programs for Options Trading

Notwithstanding the September 2000 Order, as late as 2003, there remained significant deficiencies in the Amex's surveillance, investigatory, and disciplinary programs regarding the firm quote, customer priority, trade reporting, limit order display, as well as, other options order handling rules. During the relevant time, the Amex's Derivatives Trading Analysis Department ("DTA") was primarily responsible for the Amex's regulatory surveillance program for the derivatives and options markets. In January 2002, the Amex formed the Best Execution Department ("Best Ex") within the DTA specifically to conduct surveillance reviews and investigations into whether Amex members complied with options order handling rules. Best Ex was responsible for reviewing surveillance reports for violations of the firm quote, trading ahead, trade reporting, and stopped order rules, as well as, the limit order display obligation.

When Best Ex was formed, the Amex contemplated that the department would have five individuals to carry out its functions. During the relevant time, however, Best Ex never had a staff of five. It initially had a staff of four and thereafter had four or fewer individuals. The lack of staff in Best Ex was a significant contributing factor to the Amex's inadequate surveillance, investigative, and enforcement programs for options order handling rules.

a. The Firm Quote Rule

The firm quote rule is one of the primary means of ensuring that investors receive the best price available for their orders. Notwithstanding the importance of the rule, there were multiple deficiencies in the Amex's surveillance, investigatory, and enforcement programs related the rule. The Amex improperly applied the rule, established unreasonable surveillance parameters, and failed adequately to pursue disciplinary actions for violations of the rule.

The firm quote rule, in part, requires a responsible broker or dealer⁷ to stand by the quoted price up to the full quoted size for each option series.⁸ As such, when a responsible broker or

⁷ A responsible broker or dealer is a member of an exchange who communicates quotes to other members of the exchange. See Exchange Act Rule 602(b)(65). The responsible broker or dealer frequently is the specialist for the subject security.

⁸ Options of the same class that have the same exercise price and expiration date are an option series.

