

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57241; File No. SR-Amex-2007-138)

January 31, 2008

Self-Regulatory Organizations; American Stock Exchange LLC; Order Approving a Proposed Rule Change to Establish a New Class of Off-Floor Market Makers in ETFs Called Designated Amex Remote Traders

I. Introduction

On December 19, 2007, 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 proposal to create a new class of off-floor market makers, called “Designated Amex Remote Traders” or “DARTs,” in ETF securities. The proposed rule change was published for comment in the Federal Register on December 31, 2007.<sup>3</sup> The Commission received no comments regarding the proposal. This order approves the proposed rule change.

II. Description

The Exchange proposes to create a new class of off-floor market makers in ETF securities and to make related changes to the Exchange’s AEMI trading platform.<sup>4</sup> These

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

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

<sup>3</sup> Securities Exchange Act Release No. 57022 (December 20, 2007), 72 FR 74375.

<sup>4</sup> See Securities Exchange Act Release No. 56446 (September 17, 2007), 72 FR 54303 (September 24, 2007) (approving File No. SR-Amex-2007-085) (establishing DART program in ETFs and common stocks); letter dated September 5, 2007 to Nancy M. Morris, Secretary, Commission, from Brendan E. Cryan, Managing Member, Brendan E. Cryan & Company, LLC; Jonathan Q. Frey, Managing Partner, J. Streicher & Co.; Michael Marchisi, Managing Partner, AIM Securities Co.; and Robert B. Nunn, Chief Operating Officer, Cohen Specialist, LLC (“Comment Letter”) (commenting on SR-Amex-2007-085); Securities Exchange Act Release No. 56764 (November 7, 2007), 72 FR 64095

market makers, to be called “Designated Amex Remote Traders” or “DARTs,” will electronically enter competitive quotations on a regular basis to satisfy market maker regulatory requirements. DARTs will also have to meet certain business requirements, which will include minimum performance standards as discussed below.

A DART will be a member or member organization physically located off-floor that will electronically enter competitive quotations into AEMI on a regular basis in all ETF securities to which it is assigned in the DARTs program. A DART may be either a regular or associate member of the Exchange that meets the requirements for electronic access to the Exchange’s automated systems. The proposed DARTs program is similar to the Supplemental Registered Options Traders (“SROT”) program implemented by the Amex for options,<sup>5</sup> with certain unique features. Under the DARTs proposal, an Amex specialist firm may also be a DART, although it may not be registered as a DART in securities in which it is also the specialist.

Amex’s rule already provide for one type of competing market maker in ETF securities -- Registered Traders. A Registered Trader is a member who is authorized to initiate trades in certain securities<sup>6</sup> for his or her account, while on the floor.<sup>7</sup> Like Registered Traders, DARTs will not be permitted to initiate transactions in equity

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(November 14, 2007) (immediate effectiveness of File No. SR-Amex-2007-113) (eliminating DART rules).

<sup>5</sup> See Amex Rule 993–ANTE (Supplemental Registered Options Traders).

<sup>6</sup> These include in index warrants, currency warrants, securities listed pursuant to Section 107 of the Amex Company Guide, Trust Issued Receipts, and Partnership Units.

<sup>7</sup> See Amex Rule 1A(g)-AEMI. A DART would only be permitted to submit quotations electronically from off the floor of the Exchange.

securities.<sup>8</sup> DARTs will have obligations similar to Registered Traders under Exchange rules, such as those relating to a course of dealings that contributes to the maintenance of a fair and orderly market.

Due to their lack of a physical presence in the trading crowd, which is a basic requirement of the auction market, DARTs will not participate in any post-trade allocation in connection with an auction trade. Instead, a DART's participation in an auction pair-off on the Exchange will be limited to the marketable amount of its quotation on the AEMI Book at the time of the pair-off. For purposes of the priority and parity rules of Rule 126-AEMI, a DART's quotation would be treated as another crowd order, similar to a Registered Trader.

Amex will establish minimum requirements for a DART to remain in the program, which may be modified by the Exchange from time to time. First, a DART must provide competitive quotations on a regular basis to satisfy market maker regulatory requirements.<sup>9</sup> The Exchange from time to time will determine minimum performance

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<sup>8</sup> See Amex Rule 110A(n)-AEMI.

<sup>9</sup> See proposed Rule 110A–AEMI(b)(i), which requires a DART to “provide continuous two-sided quotations in all assigned securities . . . .” This basic market maker requirement mirrors the definition of “market maker” set forth in Section 3(a)(38) of the Act, 15 U.S.C. 78c(3)(38), which requires a dealer in the security involved to hold himself out “as being willing to buy and sell such security for his own account on a regular or continuous basis.” The following additional regulatory requirements will be imposed by proposed Rule 110A–AEMI(b)(ii): “With respect to each security to which he/she is assigned by the Exchange, a DART’s transactions must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. In connection with this function, a DART is required to make competitive bids and offers as reasonably necessary to contribute to the maintenance of a fair and orderly market and shall engage, to a reasonable degree under the existing circumstances, in dealings for his/her own account when there exists a lack of price continuity, a temporary disparity between the supply of and demand for the security(ies) in which he/she is trading, or a temporary distortion of the price

standards, including a volume participation rate and trade participation rate. A DART that fails to comply with one or more of these standards may be subject to loss of all or a portion of any benefits to which it would otherwise be entitled under Amex rules by virtue of its status as a DART, including possible suspension or termination of DART status. The number of ETF securities in which a DART may be permitted to make markets will be determined by the Exchange in accordance with Commentary .05 in proposed Rule 110A–AEMI. While management anticipates starting the program with a limited group of DARTs, no specific upper limit on the number of DARTs is anticipated.

In addition to the requirements described above, a DART will be required to meet eligibility criteria similar to those specified in the SROT program, which will include:

- adequacy of resources including capital, technology, and personnel;
- history of stability, superior electronic capacity, and superior operational capacity;
- level of market-making and/or specialist experience in a broad array of securities;
- ability to interact with order flow in all types of markets;
- existence of order flow commitments;
- willingness and ability to make competitive markets on the Exchange and otherwise promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the ETF securities it trades;

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relationships between the security(ies) in which he/she is trading and the security(ies) underlying or otherwise related to such security(ies).”

- the number of member organizations requesting approval to act as a DART; and
- ability to transact in any ETF underlying markets.

The regulatory requirements applicable to DARTs will be surveilled for by the FINRA Amex Regulation Division (“FINRA Amex”) consistent with current surveillance procedures for Registered Traders on the Exchange. FINRA Amex staff will work with Amex technical staff on planning the necessary changes to AEMI to capture required surveillance data and surveilling the increased number of market makers that the program is expected to attract. Adjustments to current technology and surveillance procedures will likely also be necessitated by the fact that DARTs will not be physically located on the floor of the Exchange.

DARTs will interface with the Amex’s Floor Officials in the case of trade disputes substantially in accordance with existing procedures used for SROT. Each DART accordingly will be required to designate persons on and/or off-floor to be in direct real-time contact with Floor Officials on such matters. Regulation M will apply to DARTs in the same way that it applies to other market participants, as will Amex Rule 193 to the extent a DART is affiliated with a specialist member organization. However, no expansion of the application of Amex Rule 193 beyond current practice is intended.<sup>10</sup>

Finally, the Comment Letter had observed that a provision in proposed in SR-Amex-2007-85 relating to minimum capital requirements for DARTs is unnecessary due

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<sup>10</sup> The language in Rule 110A–AEMI(c)(ii) cross-referencing Amex Rule 193 is substantively identical to language also contained in Amex Rules 993–ANTE(d)(iii) (Supplemental Registered Options Traders) and 994–ANTE(d)(iii) (Remote Registered Options Traders), neither of which have been interpreted to expand the applicability of Amex Rule 193 beyond affiliates of specialists.

to its current inapplicability to DARTs (who will be subject to the Commission's net capital rule).<sup>11</sup> The Exchange has eliminated that provision from the current proposed rule change.

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>12</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>13</sup> which requires, among other things, that a national securities exchange's rules be designed to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Under the proposal, DARTs would be permitted to quote electronically in ETFs from off the Exchange's physical trading floor. Amex's rules already provide for one type of competing market maker in ETF securities – Registered Traders. Like Registered Traders, DARTs will not be permitted to enter quotations in equity securities. In addition, similar rules would govern the allocations of DARTs and Registered Traders, except DARTs will not be permitted to participate in a post-trade allocation in connection with an auction trade. The Commission believes it is reasonable and consistent with the Act for Amex to establish DARTs as remote competitive market makers subject to the

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<sup>11</sup> Rule 15c3-1 under the Act, 17 CFR 240.15c3-1.

<sup>12</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

allocation rules described in the proposal.

The Commission notes that DARTs will be required to meet certain eligibility requirements. The existence of order flow commitments between a DART applicant and order flow providers is one such factor. The Commission notes the Exchange's representation that a future change to, or termination of, any such commitments would not be used by the Exchange at any point in the future to terminate or take remedial action against a DART, and that the Exchange would not take remedial action solely because orders subject to any such commitments were not subsequently routed to the Exchange. Similarly, the Exchange has included the "willingness to promote the Exchange" as a factor that the Committee may consider when making its application decisions. The Commission notes the Exchange's representation that the Committee would not apply this factor to in any way restrict, either directly or indirectly, a DART's activities as a market maker or specialist on other exchanges, or to restrict how a DART handles orders it holds in a fiduciary capacity to which it owes a duty of best execution.

The Commission also notes that, should the Committee decide not to approve a DART applicant, or should an DART's appointment be suspended or terminated in one or more classes, a DART applicant or DART, respectively, would be entitled to a hearing under Article IV, Section 1(g) of the Amex Constitution and Amex Rule 40.

Proposed Amex Rule 110A(b) - AEMI sets forth the obligations that a DART would be required to fulfill. Specifically, a DART would be required to generate continuous, two-sided quotations in all assigned ETF securities. A DART's affirmative market making obligations appear to be sufficient to justify the benefits it would receive as a market maker.

The proposal also appears reasonably designed to prevent the misuse of material, non-public information with any affiliates that may conduct a brokerage business in securities assigned to a DART, or that may act as a specialist or market maker in any security underlying a derivative security assigned to a DART.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-Amex-2007-138) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).