

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54709; File No. SR-Amex-2006-72)

November 3, 2006

Self-Regulatory Organizations; American Stock Exchange LLC; Order Approving a Proposed Rule Change and Amendment No. 1 Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3, To Adopt New Rules To Implement on a Pilot Basis an Initial Version of AEMI, Its Proposed New Hybrid Market Trading Platform For Equity Products and Exchange Traded Funds

I. Introduction

On August 8, 2006, 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”)¹ and Rule 19b-4 thereunder,² a proposed rule change to implement an initial version of its Auction & Electronic Market Integration (“AEMI”) system, a new hybrid market trading platform for equity products and exchange-traded funds (“ETFs”). On September 7, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.³ The proposed rule change, as amended, was published for comment in the Federal Register on September 14, 2006.⁴ The Commission received four comments on the proposal.⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaces and supersedes the original filing in its entirety.

⁴ See Securities Exchange Act Release No. 54413 (September 7, 2006), 71 FR 54318 (“Notice”).

⁵ See Letter to Nancy M. Morris, Secretary, Commission, from Michael A. Barth, Senior Vice President, Exchange and Market Centers, Order Execution Services, Inc., dated September 22, 2006 (“OES Letter”); Letter to Nancy M. Morris, Secretary, Commission, from Mary Yeager, Assistant Secretary, New York Stock Exchange LLC, dated September 29, 2006 (“NYSE Letter”); Letter to Nancy M. Morris, Secretary, Commission, from David A. Herron, Chief Executive Officer, Chicago Stock Exchange, Inc., dated October 5, 2006 (“CHX Letter”); and Letter to Nancy M. Morris, Secretary, Commission, from Jeffrey S. Davis, Assistant General Counsel, Nasdaq Stock Market LLC, dated October 10, 2006 (“Nasdaq Letter”).

On October 31, 2006, Amex filed Amendment No. 3 to the proposal.⁶ This notice and order solicits comments from interested persons on Amendment No. 3 and approves the amended proposal on an accelerated basis.

II. Description of Proposal

The Commission recently approved the Exchange's new hybrid market platform for equity products and ETFs, known as AEMI, that will integrate automatic execution and floor-based auction trading (the "AEMI Rule Filing").⁷ The Exchange has proposed to adopt, prior to the Trading Phase Date,⁸ which is set for February 5, 2007, a modified version of the AEMI Rules, known as the "AEMI-One Rules," as a pilot program (the "AEMI-One Pilot"). The AEMI-One Pilot would commence with two listed equities and two ETF UTP securities. Following a successful ten-day period of trading, up to four listed ETFs would be added for an additional five days of trading. The Exchange would then accelerate the deployment of all equity products and ETFs on a per-post basis and give notice to members and publish on Amex's Web site the timing for each group of securities being migrated to the AEMI platform.

Because not all provisions of Regulation NMS are fully operative, the AEMI-One Pilot rules are modified from their AEMI Rule counterparts to reflect the different regulatory environments in effect before and after the Trading Phase Date. The Exchange expects that the

⁶ See Partial Amendment to Form 19b-4 dated October 27, 2006 ("Amendment No. 3"), infra Section III. The Exchange submitted Amendment No. 2 to the Commission on October 30, 2006 and withdrew Amendment No. 2 on October 31, 2006.

⁷ Securities Exchange Act Release No. 54552 (September 29, 2006), 71 FR 59546 (October 10, 2006) ("AEMI Approval Order").

⁸ By the Trading Phase Date, each trading center intending to qualify its quotations for trade-through protection must bring a Regulation NMS-compliant trading system into full operation for all NMS stocks intended to be traded during the phase-in period (i.e., through October 8, 2007). See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038, 30039 (May 24, 2006) ("NMS Extension Release") (extending compliance dates for Rules 610 and 611 of Regulation NMS).

AEMI-One Pilot would be in effect from shortly after Commission approval of the AEMI-One Rules until the Trading Phase Date. At the Trading Phase Date, the AEMI Rules would become effective and supersede the AEMI-One Rules. The Exchange has stated that it would make this change via a filing with the Commission to delete the AEMI-One Rules from its rulebook.

The operation of AEMI-One would be, in most respects, consistent with the operation of AEMI, except for the following provisions:

- A “protected quotation” in the AEMI-One Pilot (“AEMI-One Protected Quotation”) is a quotation in an NMS stock that: (1) is disseminated pursuant to an effective national market system plan; (2) is the best bid or best offer of a national securities exchange or a national securities association that is at a better price than the next trade that would occur on AEMI; and (3) is a firm manual or automated quotation, irrespective of whether the quotation is at the national best bid or offer (“NBBO”).⁹ In contrast, a “protected quotation” under the AEMI Rules is defined to be consistent with Rule 611 of Regulation NMS¹⁰ and must be an automated quotation that is the best bid or offer of an automated trading center.

- During the AEMI-One Pilot, not every away market center that displays an AEMI-One Protected Quotation may be capable of receiving intermarket sweep orders (“ISOs”), as such orders are defined in Regulation NMS.¹¹ In such circumstances, AEMI would not utilize ISOs and instead would generate “away market obligations.” An “away market obligation” is defined in the AEMI-One Rules as an immediate-or-cancel limit order generated by AEMI and routed to one or more away market centers to execute against all AEMI-One Protected

⁹ See Amendment No. 3, supra note 6.

¹⁰ See 17 CFR 242.600(b)(58) (defining “protected quotation”); see also 17 CFR 242.600(b)(57) (defining “protected bid” and “protected offer”).

¹¹ See 17 CFR 242.600(b)(30) (defining “intermarket sweep order”).

Quotations up to their displayed size.¹² If an away market that trades a particular security were capable of receiving ISOs prior to the Trading Phase Date, the Exchange could choose to require AEMI to generate and utilize ISOs as the away market obligations for that market.¹³ In contrast, the AEMI Rules effective on and after the Trading Phase Date would provide for the use of ISOs exclusively to comply with the trade-through provisions of Rule 611 for protected quotations displayed at other market centers. However, during the AEMI-One Pilot, AEMI would accept and trade all ISOs received by the Exchange that involve securities traded on the Exchange that have made the transfer from Amex's legacy systems to the AEMI platform, similar to the way AEMI would operate following the AEMI-One Pilot.¹⁴

III. Amendment No. 3

In Amendment No. 3, the Exchange proposed certain changes to conform the AEMI-One Rules to the final AEMI Rules. These conforming changes are made in Rules 24-AEMI-One,

¹² The Commission notes that the Exchange has represented that such immediate-or-cancel orders will carry an expiration delay timer that at the outset of AEMI-One will be set to 35 seconds for all away market obligations. See Letter to Nancy M. Morris, Secretary, Commission, from Claire P. McGrath, Senior Vice President and General Counsel, Amex, dated October 31, 2006 ("Amex Request Letter") (requesting exemption from Section 8(d) of the ITS Plan in connection with Amex's use of ISOs and the use of private linkages instead of ITS for routing away market obligations).

¹³ The Commission notes that as a condition to the Exchange marking an order as an ISO, the Exchange must immediately send ISOs or away market obligations, as appropriate to the trading center whose quote the Exchange is trying to access, to all AEMI-One Protected Quotations.

¹⁴ In Amendment No. 1 the Exchange, among other things, clarified that, during the period of the AEMI-One Pilot, a member of the Exchange sending an intermarket sweep order to the AEMI platform must simultaneously send an intermarket sweep order (or a comparable order) for the full displayed size of the top of book of every other market center displaying a better-priced quotation. See proposed Rule 131-AEMI-One. In Amendment No. 2, the Exchange revised proposed Rule 131-AEMI-One to state "better-priced protected quotation" (emphasis added).

115-AEMI-One, 128A-AEMI-One, 131-AEMI-One, and 170-AEMI-One. The Exchange also proposed the following:

- To change the language describing how the AEMI platform will route orders in AEMI-One to protected quotations of away markets for trade-through purposes. As described in Amendment No. 3, an AEMI-One Protected Quotation is any firm quotation, whether manual or automated, that is at a better price than the next trade that would occur on AEMI, and that is the best bid or offer of a national securities exchange or a national securities association. In contrast, a “protected quotation” under the AEMI Rules (effective on and after the Trading Phase Date) is defined to be consistent with Rule 611 of Regulation NMS and must be an automated quotation that is the best bid or offer of an automated trading center (as defined in Regulation NMS).
- To make certain changes to Rule 126A-AEMI-One to insure that the AEMI system’s handling of trade-throughs is consistent with the ITS Plan.
- To remove the orders types “buy minus” and “sell plus” from proposed Rule 131-AEMI-One(n) (and all references thereto in the AEMI-One Rules) pending additional study of their functionality in a Regulation NMS environment.
- To revise the descriptions of “stop order” in Rule 131-AEMI-One(o) and “stop limit order” in proposed Rule 131-AEMI-One(p) to provide that “too marketable” stop and stop limit orders for ETFs will be executed, not rejected.
- To codify as Commentary .01 to proposed Rule 154-AEMI-One the Exchange’s interpretation that a Specialist will not be deemed to be “trading ahead” of a percentage order (of which it is the agent) if: (1) an aggressing order that executes against the Specialist’s quote “elects” the percentage order (making it eligible for immediate

execution); and (2) the percentage order is not executed by that aggressing order due to insufficient remaining interest and therefore reverts back to unelected status.

Additionally, the Commentary would provide that any subsequent trade by the Specialist for its own account would not constitute “trading ahead” if the percentage order has not been otherwise re-elected at that time.

- To revise the definitions of “Specialist emergency quote” and “stabilizing quote” in proposed Rule 1A-AEMI-One to provide for an upper limit (not to exceed ten) on the number of Specialist emergency quotes that may be immediately generated under a possible scenario in which the Specialist pairs off through another market. Otherwise, a potentially large number of such quotations might be required to be sent out to protect quotes of away markets, creating excessive risk, before a tolerance breach occurs. Under the proposed rule change, the Specialist must re-quote its market when the above referenced limit is hit. The proposed change in the definition of “stabilizing quote” is a related change to provide that a stabilizing quote would be issued if the maximum number of Specialist emergency quotes has been reached.
- To add language to Rule 126A-AEMI-One reiterating the obligations to other market centers that members of the Exchange who choose to send ISOs to AEMI during the AEMI-One Pilot will have. This requirement also appears in proposed Rule 131-AEMI-One as described above. Such members will be obligated to protect all AEMI-One Protected Quotations.
- To clarify the meaning of the last sentence of the definition of an “intermarket sweep order” in proposed Rule 131-AEMI-One(k), by adding the word “protected” before the word “quotation.” This sentence describes the obligations to other market centers of a

member of the Exchange who chooses to send an intermarket sweep order to the AEMI platform during the AEMI-One Pilot. Such a member would be obligated to protect all AEMI-One Protected Quotations.

IV. Comments

The Commission received four comment letters regarding the proposed rule change. One commenter, OES, asserted that the proposed routing arrangements contemplate that Amex would inappropriately perform duties required to be performed by a broker-dealer, such as making decisions on when, how, and where orders are routed.¹⁵ New York Stock Exchange (“NYSE”) argued that Amex’s proposal constituted “an attempt to move forward the effective date of the Reg. NMS Order Protection Rule from February 5, 2007 to whenever the Amex is ready to implement AEMI-One.”¹⁶ NYSE also argued that Amex’s proposal would violate the Intermarket Trading System (“ITS”) Plan and give it the ability to trade-through quotes that Amex deems slow. NYSE also observed that, when Amex previewed its proposal with the ITS Operating Committee, several other markets noted that it would have a negative impact on their respective technology implementation schedules. The Chicago Stock Exchange (“CHX”) also viewed Amex’s proposed rule change as an attempt to accelerate the Trading Phase Date and opposed Amex’s proposal to trade-through quotations Amex deems to be slow.¹⁷

Nasdaq supported Amex’s proposed rule change, characterizing it as a “sensible transitional approach” that would help it prepare for the Trading Phase Date at no or little cost to other market participants.¹⁸ Nasdaq disagreed with NYSE’s comments on Amex’s proposal,

¹⁵ See OES Letter at 1. See also AEMI Approval Order, 71 FR at 59554, n. 103.

¹⁶ See NYSE Letter at 1.

¹⁷ See CHX Letter at 1.

¹⁸ See Nasdaq Letter at 1.

stating that the proposed rule change would not result in any technical or programming impact to Nasdaq, is voluntary, and could be implemented by Amex at any time without requiring other markets to implement similar functionality. Nasdaq also asserted that, when Amex previewed its plan to the ITS Operating Committee, there was no overwhelming consensus either for or against the proposal, and this is not unusual given that market participants often have competing interests. In Nasdaq's view, any concerns presented at that time about the proposal's potential impact on other markets' programming requirements were based upon a lack of familiarity with the proposal.

Amex responded to NYSE's and OES's comment letters.¹⁹ Amex disagreed with NYSE's assertion that the Trading Phase Date is the date on which all SRO trading centers will launch their respective Regulation NMS-compliant systems. Rather, Amex stated that the Trading Phase Date represents an end date by which all such systems must comply with Regulation NMS. Moreover, Amex argued that the deadline of the Trading Phase Date does not negate the desirability of providing a phase-in period for a new trading system. The Exchange asserted that the industry should have operating experience with new systems prior to the Trading Phase Date before market participants become liable for compliance. The Exchange also stated that its proposal would not create any additional technical burdens on other market centers. Amex also explained that it would not send ISOs to any market not ready to accept them and would publish the list of markets to which it would send ISOs prior to the Trading

¹⁹ See Letter to Nancy M. Morris, Secretary, Commission, from Neal L. Wolkoff, Chief Executive Officer, Amex, dated October 10, 2006 ("Amex Response Letter").

Phase Date.²⁰ The Exchange also stated that it would seek an exemption from the ITS Plan to the extent its proposal required.²¹

In response to OES's comment letter, Amex stated that the Exchange's routing functionality has no discretion and thus the Exchange would not be acting in the capacity of a broker.²² Amex further explained that the routing logic is based on pre-coded functionality which seeks to route orders to the market center displaying the best price based on price-size priority. The Exchange also stated that it does not believe that its use of routing logic or licensing of routing technology would undermine or change its ability to provide a marketplace of buyers and sellers.

The Commission notes that, in Amendment No. 2, the Exchange amended its proposal so that during the AEMI-One Pilot it would protect any firm quotation, whether manual or automated, that is at a better price than the next trade that would occur on AEMI and that is the best bid or offer of a national securities exchange or a national securities association. This change should address the comment made by NYSE and CHX that the Exchange would "be permitted to trade through quotes it deems slow"²³

V. Discussion

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 and, in particular, with the requirements of Section 6(b) of the

²⁰ See id. at 2.

²¹ See id. at 2; see also Amex Request Letter, supra note 12 (requesting exemption from Section 8(d) of the ITS Plan in connection with Amex's use of ISOs and the use of private linkages instead of ITS for routing away market obligations).

²² See Amex Response Letter at 3-4.

²³ See CHX Letter at 2; see also NYSE Letter at 1.

Act.²⁴ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act²⁵ in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission also finds that the proposal is consistent with Section 6(b)(8) of the Act,²⁶ which prohibits an exchange's rules from imposing a burden on competition that is not necessary or appropriate in furtherance of the Act. Finally, the Commission believes that the proposal is consistent with Section 11A(a)(1)(C) of the Act,²⁷ in which Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure: (1) economically efficient execution of securities transactions; (2) fair competition among brokers and dealers and among exchange markets, and between exchange markets, and markets other than exchange markets; (3) the availability to brokers, dealers, and investors of information with respect to quotations and transactions in securities; (4) the practicability of brokers executing investors' orders in the best market; and (5) an opportunity for investors' orders to be executed without the participation of a dealer. Since the Commission has already approved the final AEMI Rules,²⁸ only those aspects of the AEMI-One Rules that differ from the final AEMI Rules are discussed more fully below.

²⁴ 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁵ 15 U.S.C. 78f(b)(5).

²⁶ 15 U.S.C. 78f(b)(8).

²⁷ 15 U.S.C. 78k-1(a)(1)(C).

²⁸ See AEMI Approval Order, supra note 7.

In its AEMI-One proposal, the Exchange stated that it will protect all AEMI-One Protected Quotations – namely all quotations that: (1) are disseminated pursuant to an effective national market system plan; (2) are the best bid or best offer of a national securities exchange or a national securities association that is at a better price than the next trade that would occur on AEMI; and (3) are firm quotations, regardless of whether they are manual or automated. The Commission notes that this level of price protection appears consistent with the ITS Plan.

The Exchange plans to utilize ISOs to route orders to AEMI-One Protected Quotations of those market centers capable of receiving ISOs. For markets that are unable to receive ISOs, the AEMI-One Rules provide for the use of an “away market obligation” to reach the quotations of such markets. An “away market obligation” is an immediate-or-cancel limit order generated by AEMI in connection with the execution of an order by AEMI and simultaneously routed to one or more away market centers to execute against the full displayed size of any AEMI-One Protected Quotation. In addition, an Amex member may send an ISO to AEMI during the AEMI-One Pilot only if it has simultaneously sent an ISO (or comparable order) to execute against the full displayed size of any AEMI-One Protected Quotation. The AEMI-One Rules provide that the Exchange will accept and act upon all inbound, appropriately marked ISOs received before the Trading Phase Date that involve securities traded on the AEMI platform.

The Commission believes that the Exchange’s proposal is reasonably designed to allow Amex and its market participants to gain experience with ISOs before the Trading Phase Date. In a separate action, the Commission today is exempting Amex from certain provisions of the ITS Plan relating to the Exchange’s use of ISOs and the use of private linkages instead of ITS for

routing away market obligations.²⁹ This exemption will enable Amex to implement certain provisions of the AEMI-One Rules without violating the ITS Plan. For reasons discussed in the Amex Exemption Letter, the Commission believes that granting Amex's request for an exemption from certain provisions of the ITS Plan is warranted.

The Commission does not believe that OES's comments regarding the AEMI routing arrangements preclude approval of the AEMI-One Rules. The Commission previously considered this comment as part of the AEMI Rule Filing. For reasons discussed in the order approving that filing, the Commission believes that the Exchange's arrangements for outbound routing functionality are consistent with the Act.³⁰

Accelerated Approval of Amendment No. 3

Pursuant to Section 19(b)(2) of the Act, the Commission finds good cause to approve the proposal, as amended by Amendment No. 3, prior to the thirtieth day after the amended proposal is published for comment in the Federal Register. The changes that the Exchange proposes in Amendment No. 3 are technical in nature and raise no new issues of regulatory concern beyond those raised in the original proposal, which had a full notice-and-comment period. The Commission finds good cause to accelerate approval of the amended proposal prior to the thirtieth day after publication in the Federal Register.

²⁹ See Letter to Claire P. McGrath, Senior Vice President and General Counsel, Amex, from David S. Shillman, Associate Director, Division Commission, dated November 3, 2006 (“Amex Exemption Letter”).

³⁰ See AEMI Approval Order, 71 FR at 59554, n. 103.

VI. Solicitation of Comments on Amendment No. 3

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether the amendment is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Amex-2006-72 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Amex-2006-72. 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, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit

personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Amex-2006-72 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VII. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and in particular with Sections 6(b)(5) and 6(b)(8) of the Act.³¹

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³² that the proposed rule change (SR-Amex-2006-72), as amended by Amendment No. 1, be, and it hereby is, approved, and that Amendment No. 3 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³³

Nancy M. Morris
Secretary

³¹ 15 U.S.C. 78f(b)(5) and 78f(b)(8).

³² 15 U.S.C. 78s(b)(2).

³³ 17 CFR 200.30-3(a)(12).