

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55464; File No. SR-Amex-2007-08)

March 13, 2007

Self-Regulatory Organizations; American Stock Exchange LLC; Order Granting Approval of a Proposed Rule Change to Establish a Passive Price Improvement Order for Specialists and Registered Traders

I. Introduction

On January 19, 2007, the American Stock Exchange LLC (“Amex” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on February 2, 2007.³ The Commission received one comment letter.⁴ On March 12, 2007, Amex submitted a response to the comment letter.⁵ This order approves the proposed rule change.

II. Description of the Proposal

Amex proposes to amend the rules for its AEMI trading platform⁶ to add a Passive Price Improvement (“PPI”) order type. PPI orders are undisplayed orders that, to execute, would have

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Release Act 55179 (January 26, 2007), 72 FR 05091 (February 2, 2007).

⁴ See Letter from Christopher Cornette, Member, Amex, to Florence E. Harmon, Deputy Secretary, Commission, received February 14, 2007.

⁵ See Letter from Claire P. McGrath, Senior Vice President & General Counsel, Amex, to Nancy M. Morris, Secretary, Commission, dated March 12, 2007 (“Amex Response Letter”).

⁶ See Securities Exchange Act Release No. 54552 (September 29, 2006), 71 FR 59546 (October 10, 2006).

to be inside the automated best bid and offer of the Exchange (also referred to as the "Amex Published Quote" or "APQ") by at least a tick. They would be the only method for Specialists and Registered Traders to offer price improvement electronically. A Specialist or Registered Trader would have to have at least one active quote on a particular side of a security on the AEMI book to enter and maintain a PPI order in the same security on the same side. A Specialist or Registered Trader that meets this quoting requirement could enter only one PPI order on each side for a security. A PPI order could not form part of the APQ and would be visible only to the entering Specialist or Registered Trader (or his firm).

AEMI would make a PPI order eligible for execution if at least one of the following conditions were met:

1. The Specialist's or Registered Trader's displayed quote is at the APQ on the side of the PPI order that would be executed. In this case, the PPI order would be executed up to (a) the size of the Specialist's or Registered Trader's displayed quote on that side or (b) the size of the incoming order, whichever is smaller.
2. The Specialist's or Registered Trader's displayed quote is one tick away from the APQ on the side of the PPI order that would be executed. In this case, the PPI order would be executed up to (a) half of the size of the Specialist's or Registered Trader's displayed quote on that side or (b) the size of the incoming order, whichever is smaller.

The AEMI system would ignore (i.e., make ineligible for execution against an otherwise marketable aggressing order, without canceling) the remaining size of a PPI order beyond the thresholds described above.⁷ The AEMI system would also ignore a PPI order in the following circumstances:

⁷ For example, assume that a Specialist's bid for 1,000 shares is part of the Amex best bid and there are no better-priced protected quotations at other trading centers. The

- The PPI order locks or crosses the automated NBBO or APQ as a result of a change in the automated NBBO or APQ;
- The PPI order equals the APQ on the same side of the market;
- There is a negotiated trade; or
- AEMI's auto-execution functionality is disabled.

In addition, the AEMI system would cancel a PPI order in three circumstances: (1) if the Specialist's or Registered Trader's best quote is withdrawn; (2) at the end of the day; or (3) there is a trading halt in the security.

If there were multiple PPI orders at the same price, the Specialist's PPI order would have priority, and any remaining size of an aggressing order would be executed against Registered Trader PPI orders in time priority. Intermarket sweep orders would be generated as necessary to clear any better-priced protected quotations at other trading centers before executing any PPI orders on the AEMI system.

To reflect the proposed rule change as described above, changes are proposed to the following AEMI rules: Rule 123–AEMI (Manner of Bidding and Offering), Rule 131–AEMI (Types of Orders), Rule 157–AEMI (Orders with More than One Broker), and Rule 170–AEMI (Registration and Functions of Specialists).

Specialist has a PPI order to buy 3,000 shares priced one tick better than the Amex best bid. Assume that an incoming market order to sell 3,000 shares is received by AEMI. The system would execute 1,000 shares against the Specialist's PPI order, and the remainder would execute one tick down at the Amex best bid (based on the Exchange's rules of priority and parity). The remaining size of the PPI order (2,000 shares) is ignored because the PPI order may execute only up to the size of the Specialist's displayed bid at the APQ.

III. Summary of Comments and Amex Response

The Commission received one comment letter opposing the proposed rule change. The commenter argued that limiting the use of PPI Orders to Specialists and Registered Traders gives them "an unfair advantage" and thus is not consistent with Section 6(b) of the Act.

The commenter noted that the Specialist would have access to aggressing orders that could be price-improved but Floor Brokers would not. The commenter suggested that there would be many instances where Floor Brokers would be willing to provide price improvement but would not publicly display such interest in order to minimize any potential market impact. The commenter also suggested that PPI Orders could be misused to trade ahead of a Floor Broker's marketable orders instead of providing price improvement.

In its response to comments, Amex asserted that Floor Brokers are able to operate effectively and compete with Specialists and Registered Traders. For example, Amex pointed out that Floor Brokers have the exclusive use of certain order types on AEMI (e.g., percentage orders and reserve orders). Amex also emphasized that the use of PPI Orders would be monitored and policed electronically. Amex stated that its regulatory program would be able to detect possible unfair trading practices. Finally, Amex represented that it "is in the process of developing the means by which other market participants, including floor brokers, would have the ability to systematically provide such price improvement."⁸

IV. Discussion and Commission's Findings

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to

⁸ Amex Response Letter at 1.

a national securities exchange.⁹ In particular, the Commission finds that the proposal is consistent with the requirements of Section 6(b)(5) of the Act,¹⁰ which requires, among other things, that the Exchange's rules be 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 previously has found similar exchange rules to be consistent with the Act.¹¹ The Commission does not believe that the comment raises any issue that would preclude approval of the current proposal. As the Commission noted in the NYSE Hybrid Approval Order, Specialists today are permitted to offer price improvement to incoming orders in the auction market.¹² In this proposal, Amex seeks to provide its Specialists and Registered Traders with the ability to continue to offer price improvement in an electronic environment, but only if certain conditions are met. A Specialist's or Registered Trader's PPI order is eligible for execution only if its quote on the same side of the market is at or one tick away from the APQ. If the Specialist's or Registered Trader's quotation is at the APQ, a PPI order is eligible to execute up to the same size as its quotation; if it is one tick away from the APQ, the PPI order is eligible to execute up to one half the size of its quotation. A PPI order will be ignored if the Specialist's or Registered Trader's quotation is more than one tick away from the APQ. Thus, a Specialist's ability to benefit from the PPI order is directly correlated with the extent to which it

⁹ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ See Securities Exchange Act Release Nos. 53539 (March 22, 2006), 71 FR 16353, 16381-82 (March 31, 2006) ("NYSE Hybrid Approval Order") and 54511 (September 25, 2006), 71 FR 58460 (October 3, 2006).

¹² See 71 FR at 16382.

quotes competitive markets in size. The Commission notes, moreover, that Amex has represented that it "is in the process of developing the means by which other market participants, including floor brokers, would have the ability to systematically provide such price improvement."¹³

The Commission further notes that a PPI order could execute only against a marketable incoming limit order. An incoming order that is not marketable against a PPI order (or a protected quotation) and that improves the APQ would be quoted as part of the new APQ.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-Amex-2007-08), be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Florence E. Harmon
Deputy Secretary

¹³ Amex Response Letter at 1.

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).