

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55762; File No. SR-Amex-2007-47)

May 15, 2007

Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Change the Method By Which Specialists on the Exchange Execute Odd-Lot Market Orders Under Rule 205—AEMI

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 11, 2007, the American Stock Exchange LLC (“Amex” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. Amex has filed this proposal pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(5) thereunder,⁴ which renders it effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt changes to Rule 205—AEMI in order to change the method by which specialists on the Exchange execute odd-lot market orders.

The text of the proposed rule change is available on Amex’s Web site at <http://www.amex.com>, at the Exchange’s principal office, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(5).

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Amex included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Amex has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange is currently operating, and has adopted rules in connection with the operation of, its new hybrid market trading platform for equity products and exchange-traded funds, designated as AEMISM (the Auction and Electronic Market Integration platform). Rule 205—AEMI (“Manner of Executing Odd-Lot Orders”) requires the specialist for a relevant security to be the contra-party for executions of any odd-lot orders in that security received by AEMI and specifies, in relevant part, the pricing at which such executions must occur. In the case of odd-lot market orders that are not executed within 30 seconds of receipt by AEMI, the specialist is currently required to execute such orders at the price of the qualifying national best bid or offer (“NBBO”). In order to ensure a fair and orderly market, the Exchange proposes to amend Rule 205—AEMI to provide for such odd-lot market orders to now be executed at the specialist’s quote, rather than the NBBO.

(i) How Rule 205—AEMI works today

Rule 205—AEMI(b)(i)-(iii) currently requires the specialist to execute a market odd-lot order at the price of a subsequent round-lot execution that occurs in the subject security on the

Exchange for 30 seconds after the odd-lot order is entered. However, a market odd-lot order is executed at this round-lot price only to the extent that there are a sufficient number of shares subsequently transacted in round-lots on the Exchange within that 30 second window to match any imbalance between the pending odd-lot market buy and sell orders. If there are an insufficient number of shares in round-lot executions within that 30 seconds from which to benchmark the market odd-lot execution price of the imbalance, Rule 205—AEMI(b)(iv) dictates that the NBBO be used as the default price at which the specialist is required to execute.⁵

(ii) The identified deficiency in Rule 205—AEMI

It has become apparent to the Exchange that the current version of Rule 205—AEMI (insofar as it forces the specialist to execute any unexecuted imbalance in odd-lot orders at the NBBO) provides too much opportunity for manipulation to the detriment of both the specialists and accuracy in pricing. In practice, the Exchange has recently observed a high number of odd-

⁵ Applying the rule, assume AEMI receives market odd-lot buy orders aggregating 1,500 shares and market odd-lot sell orders aggregating 3,500 shares in a security. The next and only round-lot execution on the Amex within the next 30 seconds is 500 shares at \$10, and, at the expiration of the 30 seconds, the NBB is 100 shares at \$10.50 on NYSE. The specialist is required in time priority of receipt of the odd-lot orders into AEMI to:

- Sell/buy an equal number of shares on each side of the odd-lot market at \$10, which clears the 1,500 shares of odd-lot market buy orders and leaves an imbalance of 2,000 of the original 3,500 shares of odd-lot market sell orders.
- In response to the remaining 2,000 shares of odd-lot market sell orders, buy a maximum of 500 shares at \$10 because that is the total size of subsequent round-lot transactions within the 30-second window. (This assumes that the remaining odd-lot sell orders with greatest time priority total 500 shares exactly. If a partial execution would result by stopping the specialist from buying at \$10 once the 500 share threshold was reached, then the specialist could buy more than 500 shares at \$10 so as to permit execution in full of the last odd-lot order at that price. See Rule 205—AEMI(b)(ii).)
- At the expiration of 30 seconds, purchase the 1,500 shares remaining from the odd-lot sell orders at \$10.50 (the NBB), even though the NBB was for only 100 shares and might not reflect the price at which the specialist would or should otherwise be willing to purchase 1,500 shares.

lot market orders in less liquid securities and believes that this is a direct result of the rule's guarantee of execution at the NBBO irrespective of whether the size or timeliness of the NBBO is comparable to those of the odd-lot orders on the Exchange. The Exchange is concerned that off-floor participants may be breaking up larger round-lots into multiple odd-lots to take advantage of NBBO pricing on the Exchange where such pricing would be unattainable if the larger orders were submitted and price discovery was possible. This behavior would violate Exchange rules⁶ but unfortunately can be ascertained only via case-by-case post-trade investigation. Additionally, in the case of very highly-priced, yet thinly traded, securities, specialists are bearing inappropriate burdens as odd-lot dealers as well. Below are two examples of what can occur:

- Assume that an illiquid security has an average daily volume of 15,000 shares. Assume also that the NBBO is \$5.00 bid for 100 shares on NASDAQ and 500 shares offered at \$5.10 on NYSE. The liquidity around the NBBO is very thin, and no round-lot executions have taken place over the last four hours, during which period Amex nonetheless receives many odd-lot market orders. In accordance with Rule 205—AEMI, each odd-lot order is executed after 30 seconds against the specialist at the NBBO automatically, although the specialist is not quoting at the NBBO, the NBBO has not changed, and no round-lot trades have occurred in the marketplace.

⁶ See Rule 4 (generally prohibiting manipulation of securities prices) and Rule 208 (applicable in AEMI via Rule 1A—AEMI(d)), entitled “Bunching of Odd-Lot Orders,” which provides in relevant part:

When a person gives, either for his own account, for various accounts in which he has an actual monetary interest, or for accounts over which such person is exercising investment discretion, buy or sell odd-lot orders which aggregate one or more round-lots, a member or member organization shall not accept such orders for execution unless they are, as far as possible, consolidated into round-lots, except that selling orders marked “long” or “short exempt” need not be so consolidated with selling orders marked “short.”

Over the course of the four hours, the specialist is forced to purchase an aggregate of 10,553 shares in odd-lots, each at a price of \$5.00, even though grossly disproportionate to the 100 share order size connected to the \$5.00 NBB, the overall activity in the marketplace, and the likely lower value at which an equivalent aggregate volume of round lots would have transacted in such an illiquid market. As such, the specialist is forced to bear an inappropriate amount of risk of loss as odd-lot dealer because, rather than price discovery being permitted to occur as would occur with round-lot quotes, the specialist is forced to purchase all of the odd-lots at the stale NBBO price.

- Assume a very highly-priced thinly-traded security with an NBBO of 100 shares bid for \$800 on NASDAQ and 100 shares offered at \$806 on NYSE. Because of the high price of the shares, round-lot executions are infrequent and no round-lot executions have taken place on Amex over the last four hours. Nonetheless, Amex receives multiple odd-lot market sale orders aggregating 367 shares over that time period. In accordance with Rule 205—AEMI, each odd-lot order is executed after 30 seconds against the specialist at \$800, and, over the course of the four hours, the specialist is forced to purchase an aggregate of 367 shares in odd-lots at \$800 per share for \$293,600. Because of the high stock price, the absence of price discovery amplifies the costs to the specialist in the event of disparity between the stale NBBO and the true value of the security. Had the mandatory \$800 bid been reduced by a mere 0.5% (to \$796) – to reflect what a hypothetical reasonable investor would pay for a thinly-traded \$800 security with an imbalance of sell interest in the market – the aggregate outlay would be \$1468 less.

(iii) The solution

As described above, the Exchange believes that the way odd-lot market orders are currently being executed today (only insofar as the NBBO price is imposed under Rule 205—AEMI(b)(i)-(iv) as a default price upon the specialists in the absence of a sufficient number of round-lot order executions on the Exchange within 30 seconds of each odd-lot market order) is inconsistent with the specialists' obligations to quote and maintain a fair and orderly market. Moreover, odd-lot orders are not subject to the Limit Order Display Rule⁷ or Order Protection Rule⁸ under Regulation NMS and do not have the same standing as round-lot orders with regard to price protection. Accordingly, the Exchange proposes to change the default price in Rule 205—AEMI(b) under which specialists are required to execute odd-lot market orders not executed within 30 seconds after receipt by AEMI from the NBBO to the specialist's own best bid or offer.

The Exchange believes that this proposal properly balances a more reasonable level of risk exposure for the specialists with their obligation to trade odd lots and deliver timely executions to investors. In particular, the proposal would permit price discovery to occur (via programmed automated adjustments flowing from executions against the specialist's quote) while still requiring the specialist to provide timely executions of odd-lot market orders. As such, executions of odd lots on the Exchange will be more likely to occur at prices which reflect the most current market conditions. In this regard, the Exchange points out that specialists are specifically required by Exchange rules to formulate quotes to avoid wide swings in the pricing of prior and subsequent transactions,⁹ so the substitution of the specialist's quote for the NBBO

⁷ 17 CFR 242.604.

⁸ 17 CFR 242.611.

⁹ Commentary .03 to Rule 170—AEMI provides in relevant part: “A specialist's

in Rule 205—AEMI is not intended to, and should not result in, unreasonably priced executions of odd-lot market orders.

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The proposed rule change would result in the following textual changes in Rule 205—AEMI:

- Substitution of the words “specialist’s best bid” and “specialist’s best offer” for “qualified national best bid” and “qualified national best offer” where such terms appear in the rule.
- Removal of Commentary .04 to the rule, which deals solely with explaining the definition of “qualified national best bid or offer,” which will no longer be relevant to Rule 205—AEMI.

2. Statutory Basis

The proposed rule change is designed to be consistent with Section 6(b) of the Act,¹⁰ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹¹ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and national market system, and, in general, to protect investors and the public interest.

quotation, made for his own account, should be such that a transaction effected at his quoted price or within the quoted spread . . . would bear a proper relation to preceding transactions and anticipated succeeding transactions or, in the case of ETFs or other derivatively priced securities, to the value of underlying or related securities.”

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

B. Self-Regulatory Organization's Statement on Burden on Competition

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the proposed rule change does not: (1) significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) have the effect of limiting the access to or availability of an existing order entry or trading system of the Exchange, the foregoing rule change has become effective immediately pursuant to Section 19(b)(3)(A)(iii) of the Act¹² and Rule 19b-4(f)(5) thereunder.¹³ At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form at <http://www.sec.gov/rules/sro.shtml>; or

¹² 15 U.S.C. 78s(b)(3)(A)(iii).

¹³ 17 CFR 240.19b-4(f)(5).

- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-Amex-2007-47 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 No. SR-Amex-2007-47. 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 No. SR-Amex-2007-47 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Florence E. Harmon
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).