

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56959; File No. SR-Amex-2007-46)

December 13, 2007

Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Require Specialists to Yield Orally Agreed Upon Proprietary Trades to Later-Arriving Customer System Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on May 10, 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 and II below, which Items have been substantially prepared by the Exchange. On December 4, 2007, Amex filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposal on an accelerated basis.

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

The Exchange proposes to amend Amex Rule 950 – ANTE to require specialists to yield proprietary transactions in options to later arriving off-Floor customer system agency orders that enter and are displayed on the specialist’s Book (“Agency Orders”) and could take the specialist’s place in the proprietary transaction.

The text of the proposed rule change is available at the Amex, the Commission’s Public Reference Room, and [www.cboe.com](http://www.cboe.com).

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

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

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

In its filing with the Commission, the Amex included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Amex states that ANTE Public Orders Ahead Block ("Block") is the functionality designed to assist specialists in complying with their agency obligations, and prevents specialists from trading ahead of a public customer order in violation of the priority rules, unless the trade is marked as meeting one of the proposed specified exceptions in the Exchange's rules.

The Amex is proposing to add new Commentary .04 to Amex Rule 950-ANTE (1) to codify these exceptions to the requirement that options specialists yield proprietary transactions to later arriving Agency Orders that enter and are displayed on the options specialist's Book and could take the options specialist's place in the not yet reported proprietary transaction.

Exchange rules require specialists to always yield to customer orders on the Book when trading in their specialty securities for their dealer account. When no other interest

is present on the specialists' Book, specialists may trade for their own account with interest represented on the Book or in the trading crowd.<sup>3</sup>

The Exchange proposes to add Commentary .04 to paragraph (l) of 950 – ANTE to specify certain limited exceptions when options specialists are not required to yield to customers orders on the Book when trading for their own account. These exceptions are as follows:

(i) if the later arriving order is an off-Floor system order for the account of a broker-dealer (including, but not limited to, a foreign broker-dealer, Registered Options Trader, Supplemental Registered Options Trader, Remote Registered Options Trader, or Away Market Maker);<sup>4</sup>

(ii) if the specialist's trade for his or her dealer account is a trade effected pursuant to Rule 950-ANTE(d), Commentary .01 or Commentary .07(b);

(iii) if the specialist's trade for his or her dealer account is a report of principal participation on an order sent to another market center through Options Intermarket Linkage and the system order arrived after the specialist sent the Linkage order;

(iv) if the specialist's trade for his or her dealer account is in connection with a P/A order sent to another market center through the Options Intermarket Linkage; or

(v) if the specialist's trade for his or her dealer account is a correction of a bona fide specialist error.

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<sup>3</sup> See Amex Rule 150(b), Rule 155 and Rule 170 generally made applicable to options by Rule 950 -ANTE (a) and (l).

<sup>4</sup> Pursuant to 900—ANTE (b)(48), an “Away Market Maker” is a market maker, as defined in Section 3(a)(38) of the Act, in options registered as such on such other national securities exchange.

These exceptions are discussed in more detail below:

#### Priority Over Accounts of Broker-Dealers

Because, pursuant to Amex Rule 950-ANTE, orders for the accounts of broker-dealers do not have priority over specialists acting as principal, the Block allows for the specialist not to yield to such orders.

#### Complex or Combination Trade Priority

Specialist participation in a transaction effected pursuant to Rule 950-ANTE(d), Commentary .01 or Commentary .07(b) is not subject to the requirement to yield, consistent with the limited priority exceptions that already exists for certain transactions, such as those involving complex or combination orders.<sup>5</sup>

The specialist will not be required to yield to Agency Orders if the specialist's trade for his or her dealer account is: (1) a complex trade such as a spread, straddle, ratio, or combination transaction pursuant to Commentary .01 to Rule 950-ANTE (d); or (2) if the specialist is participating in a "split price priority" transaction, or a pair of purchase or sale priority transactions.

When a specialist participates in a trade with a broker or market maker that constitutes a complex trade (spread, straddle, etc.), the specialist must enter the execution into the trading system (ANTE). Whenever the specialist participates in a transaction in ANTE where he enters his interest and it is on the same side of a customer order at the same price level, the quantity going to the specialist is automatically swapped with that requested by the customer order. In the case where the transaction is a spread trade, the specialist can click a button labeled "spread" to indicate the trade is a spread trade, and

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<sup>5</sup> The priority exception requires the specialist to improve the market on one "leg" of the complex trade, which must be marked as a "spread" transaction.

the system will not automatically swap the quantity allocated to the specialist with that of the customer thereby allowing the specialist to receive the execution. For example:

- A Floor Broker walks into the crowd with a spread trade request.
  1. Buy 10 Intel Jan 25 calls at \$5 (Amex quote = 4.90 x 5)
  2. Sell 10 Intel Jan 25 puts at \$1 (Amex quote = 0.95 x 1.05)
- There is a customer order to sell 10 contracts at \$5, which could be an existing order or one that comes in after the Floor Broker enters the crowd. The specialist executes the spread trade buying 10 Jan 25 puts @ 1 and selling 10 Jan. 25 calls @ 5. The specialist enters the transaction into the trading system and indicates the trade is a spread trade by clicking the spread button.

In the foregoing, when entering the transaction into the system, if the specialist does not click the “spread” button, the 10 contracts allocated to him at \$5 will be swapped with the customer order. However, in the above example, because the specialist indicates the spread transaction by clicking “spread”, the quantity is allocated to the specialist and not to the customer.

The processing for split price priority is the same as that for complex trades.<sup>6</sup> If the specialist indicates both executions are split price executions by clicking the “spread” button, the trading system will allow the transaction to process ahead of any customer orders on the book.<sup>7</sup> For example:

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<sup>6</sup> Pursuant to Commentary .07(b) to Amex Rule 950-ANTE (d), this exception applies to orders of 100 contracts or more.

<sup>7</sup> The Exchange states that when a specialist marks a trade as "spread", it is reported to the tape as a spread transaction although the trade may not necessarily be a spread trade. FINRA conducts surveillance to monitor whether specialists are inappropriately marking trades as spread, when the trade does not qualify for such treatment pursuant to Amex Rule 950 - ANTE (d), Commentaries .01 or .07(b).

- A Floor Broker walks into the crowd with an order to buy 100 @ \$5 or, an order comes into the system to buy 100 @ \$5.
  1. Amex quote = 4.80 x 5
  2. There is a customer order to sell 10 at \$5.
- The specialist executes the buy order 50 @ \$4.90 (this price is better than the ABBO and customer orders price) and 50 @ \$5, against the specialist account or he enters a trade for the specialist account to match against the Brokers order – 50 @ \$4.90 and 50 @ \$5.

When the specialist enters the transaction into the trading system, he or she can indicate the split price trade by clicking the “spread” button just as he or she does for the execution of complex trades. By doing so, the system allows the quantity allocated to the specialist to remain with the specialist. As noted above, if the specialist does not click on the “spread” button, then 10 of the 50 contracts allocated to the specialist will be allocated to the customer instead.

#### Certain Linkage Transactions

The Block will not be triggered if:

- (1) the specialist's trade for his or her dealer account is a report of principal participation on an order sent to another market center through Options Intermarket Linkage prior to the time the Agency Order was displayed on the Book;<sup>8</sup> or
- (2) the transaction is in connection with a P/A order sent to another market center through the Options Intermarket Linkage.

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<sup>8</sup> The Block will be triggered if an eligible Agency Order is displayed on the Book at the time the specialist attempts to send a principal order to another market.

A specialist who participates as principal on an order sent to another market center through Options Intermarket Linkage is not required to yield to an Agency Order that arrives subsequent to the time the specialist sent a principal linkage commitment, but prior to receiving a report of execution back. In this case, the specialist has time priority to the Agency Order since the proprietary trade has already taken place. Furthermore, a specialist is not required to yield to an Agency Order where a specialist is obligated to trade with an order on the book on the basis of receiving an execution report of a “P/A” order (as defined in Amex Rule 940(b)(10)(i)), sent to another market center through Options Intermarket Linkage. Under applicable linkage rules, this trade was done expressly on behalf of a customer order, and the specialist must relinquish the position to the customer upon receiving the execution report.<sup>9</sup> The exception ensures that the specialist maintains this obligation.

#### Correction of a Bona Fide Error

Specialist options errors are processed outside of the ANTE trading system by Exchange staff through Exchange error corrections facilities. In circumstances in which a specialist must correct a bona fide error, if the correction involves principal participation and an Agency Order is present on the Book at the time of the correction, there is no requirement that the specialist yield to later arriving customer Agency Orders. All errors are appropriately documented and reported to the Exchange, by the Service Desk, in a manner designated by the Exchange.

Although ANTE has systematized the functionality required by the proposed exceptions codified in proposed Commentary .04 to Amex 950-ANTE(l), the Exchange

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<sup>9</sup> See Amex Rule 941(b)

wishes to advise that there is an inherent limitation in fully systematizing this functionality. The ANTE trading system combines the electronic routing, quoting and execution of options orders with on floor auction market trading in options. In this regard, specialists can and will be involved in orally consummated orders. Often these “crowd trades” involve a number of registered options traders as contra-parties to the transaction together with the specialist. To enable timely trade reporting, the specialist may report a crowd transaction without all of the names of the contra-parties reflected, and shortly thereafter submit an Action without an Order (known as an “AWO”) to provide the names of all counter-parties to the trade. If the specialist is a party to the trade, his participation must be reported on either the trade report or the AWO. The trading ahead block will replace his participation if a later arriving off-floor customer agency order is entitled to participate in the specialist’s place. However, it is theoretically possible that if there was a customer agency order on the specialist book at the time of the trade report that was cancelled prior to the AWO, the trading ahead block would not be able to replace the specialist’s participation with the customer. Similarly though, a customer order could be entered subsequent to the trade report but prior to the AWO, and in such a situation the specialist’s participation will be replaced.

Because the specialist has the ability to delay reporting his participation in a transaction there is of course the potential that a specialist may inappropriately use this ability to avoid being replaced by a customer order. While the Exchange acknowledges that this type of inappropriate action could happen, a specialist delaying the reporting of his participation to avoid being replaced by a customer order runs the risk that the customer order does not cancel or otherwise get executed, or the risk that additional

customer orders arrive that could also replace the specialist's participation. However, FINRA conducts routine surveillance to identify situations in which a specialist traded ahead of an order by the use of an AWO to report his participation after the reporting of a transaction. The Exchange states that to date, this surveillance indicates that specialists generally report their proprietary participation at the time of the trade report, rather than through a later AWO. Moreover, even when a later AWO is used, FINRA has only identified two possibly valid trading ahead alerts, which are currently under review. To the extent violative conduct is found to have occurred, the Amex will take appropriate disciplinary action against the specialist in question.

The Exchange notes that the foregoing amendment to Commentary .04 to 950-ANTE(l) shall remain applicable until the Amex Book Clerk ("ABC") program has been fully implemented.<sup>10</sup> The ABC program eliminates the obligation and ability of Exchange options specialists to execute orders as agent in his or her assigned options classes. Rather, an Exchange employee or independent contractor, the ABC shall be responsible for maintaining and operating the customer limit order book and display book. The Amex anticipates a six month rollout period of ABC program.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>11</sup> in general and furthers the objectives of Section 6(b)(5) of the Act<sup>12</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices,

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<sup>10</sup> See Securities Exchange Act Release No. 56804 (November 16, 2007), 72 FR 66002 (November 26, 2007) (SR-Amex-2006-107).

<sup>11</sup> 15 U.S.C. 78f(b)

<sup>12</sup> 15 U.S.C. 78f(b)(5).

to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities, 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; and is designed to prohibit unfair discrimination between customers, issuers, brokers and dealers. Specifically, the Exchange believes that conforming the Exchange's rule text to the ANTE Public Orders Ahead Block functionality is consistent with the protection of investors and the public interest, and would sooner afford market participants the benefits that should flow from the proposal.

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

The Exchange does not believe that the proposed rule change will 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

The Exchange states that no written comments were solicited or received with respect to the proposed rule change.

III. 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

(<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Amex-2007-46 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-2007-46. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of Amex. 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-2007-46 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

#### IV. Commission Findings and Accelerated Approval

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 a national securities exchange<sup>13</sup> and, in particular, the requirements of Section 6 of the Act.<sup>14</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>15</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities, 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, because the proposed rule change modifies the Exchange's ANTE system to systematically prevent a specialist from trading ahead of public customer orders except in those limited circumstances that are enumerated in the proposed rule.

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice of filing thereof in the Federal Register as the proposal does not significantly affect the protection of investors or the public interest, and does not impose

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<sup>13</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78f.

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

<sup>16</sup> 15 U.S.C. 78s(b)(2).

any significant burden on competition. The Commission notes that the proposed rule change codifies the system changes made in response to certain undertakings made by the Amex.<sup>17</sup> Moreover, the Commission believes that granting accelerated approval to this proposed rule change will allow these changes to be effective without delay and to remain in effect during the transition to the ABC program.<sup>18</sup>

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>19</sup> that the proposed rule change (SR-Amex-2007-46), as amended, be, and is hereby approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>17</sup> See Securities Exchange Release No. 55507 (March 22, 2007).

<sup>18</sup> See supra note 10 and accompanying text.

<sup>19</sup> 15 U.S.C. 78s(b)(2).

<sup>20</sup> 17 CFR 200.30-3(a)(12).