

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49449; File No. SR-Amex-2004-04)

March 19, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 thereto by the American Stock Exchange LLC Relating to Auto-Ex for Exchange Traded Funds and Nasdaq Securities Traded on an Unlisted Basis

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> notice is hereby given that on January 20, 2004, 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 prepared by the Amex. On March 4, 2004, the Amex amended the proposed rule change.<sup>3</sup> On March 11, 2004, the Amex amended the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Amex seeks to revise its Auto-Ex procedures for Portfolio Depository Receipts, Index Fund Shares, Trust Issued Receipts (collectively referred to as “Exchange

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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> See letter from William Floyd-Jones, Associate General Counsel, Amex, to Nancy Sanow, Assistant Director, Office of Market Supervision (“OMS”), Commission, dated March 3, 2004 (“Amendment No. 1”). In Amendment No. 1, the Amex restated the proposed rule change in its entirety.

<sup>4</sup> See letter from William Floyd-Jones, Associate General Counsel, Amex, to Nancy Sanow, Assistant Director, OMS, Commission, dated March 11, 2004 (“Amendment No. 2”). In Amendment No. 2, the Amex restated the proposed rule change in its entirety.

Traded Funds” or “ETFs”), and Nasdaq securities admitted to trading on an unlisted basis. The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

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### **Trading in Nasdaq National Market Securities**

**Rule 118** (a) through (k) no change

(l) & (m) (proposed in unapproved Amex rule filings)

(n) An institutional order is a limit order for a Nasdaq National Market Security of 10,000 shares or more transmitted to the order book electronically which is to be executed automatically in full at one price. If it is not executed automatically in full at one price, it is to be routed to the specialist for execution and may be partially executed. Unlike an all or none order, an institutional order has standing on the limit order book. An institutional order may not be entered for the proprietary account of a broker-dealer.

### **[Automatic Execution for Nasdaq National Market Securities (Temporary)]**

**[Rule 118A-T.** (a) An Auto-Ex eligible order in a Nasdaq National Market System security will be executed automatically at the Amex Published Quote ("APQ") for such security in accordance with the provisions of this rule.]

(b) An Auto-Ex eligible order for a Tier 1 Nasdaq National Market security must be a round lot, or partial round lot ("PRL"), market or marketable limit order for 1,000 shares or less received by the Exchange electronically. An Auto-Ex eligible order for a Tier 2 Nasdaq National Market security must be a round lot, or PRL, market or marketable limit order for 500 shares or less received by the Exchange electronically. For purposes of this Rule, a "Tier 1" Nasdaq National Market security is a stock with an

average daily consolidated trading volume of over 10 million shares during the preceding calendar quarter, and a "Tier 2" Nasdaq National Market security is a stock with an average daily consolidated trading volume of 10 million shares or less during the preceding calendar quarter.]

[(c) The specialist will be the contra side to each Auto-Ex execution. In the event that the specialist trades as a result of an automatic execution at a price at which the specialist could have executed one or more limit orders on the book, the specialist shall immediately execute any such limit orders at the price of the Auto-Ex trade to the extent such booked orders would have been executed had the incoming order not been executed automatically.]

[(d) An Auto-Ex eligible order will be routed to the specialist and will not be automatically executed in the following situations:

(i) Auto-Ex will be turned-off for one or more securities when the specialist, in conjunction with a Floor Governor or two Floor Officials, determine that quotes are not reliable and the Exchange or the Nasdaq Stock Market is experiencing communications or systems problems, "fast markets," or delays in the dissemination of quotes.

(ii) Auto-Ex will not occur if it would cause the election of a stop or stop limit order on the book, or it would cause a trade to occur through the price of an all or none order on the book.

(iii) Auto-Ex will not occur in a stock for 10 seconds after there has been an Auto-Ex trade in that security.

(iv) Auto-Ex will not occur in a stock when the spread in the Amex Published Quote in that security is equal to or greater than thirty cents.

(v) Auto-Ex will not occur in a stock when the Amex Published Quote on the opposite side of an incoming order is not at the NBBO for that security.

(vi) Auto-Ex will not occur when the size displayed in the APQ on the opposite side of an incoming order is less than the size of the incoming order.

(vii) Auto-Ex will not occur when an incoming order is larger than the applicable Tier 1 or Tier 2 size parameter for that stock.]

[(e) The Auto-Ex Enhancements Committee ("Committee") will review a request from a specialist with respect to one or more securities to:

(i) Increase the size of Auto-Ex eligible orders above 1,000 share Tier 1 or 500 share Tier 2 parameters,

(ii) Reduce the duration of the 10-second pause between Auto-Ex executions, and/or

(iii) Increase the number of trades before the implementation of the 10-second pause in Auto-Ex described in paragraph (d)(iii) above.

The Committee may approve, disapprove or conditionally approve such requests.

The Committee will balance the interests of investors, the specialist, and the Exchange in determining whether to grant a specialist's request to modify the Auto-Ex parameters specified in (i) through (iii) of paragraph (e) of this Rule. The Committee also will consider a request from a specialist to reduce Auto-Ex parameters that previously had been increased, provided, however, that the Committee may not reduce the Auto-Ex parameters below the floors stated in paragraphs (b) and (d) of this Rule. The Committee

may delegate its authority to one or more Floor Governors. The Committee will meet promptly to review a Governor's decision to modify Auto-Ex parameters in the event that a Governor acts pursuant to delegated authority.]

**[Automatic Execution for Exchange Traded Funds]**

**[Rule 128A.** The Exchange shall determine the size and other parameters of orders eligible for execution by its Automatic Execution System (Auto-Ex). An Auto-Ex eligible order for any account in which the same person is directly or indirectly interested may only be entered at intervals of no less than 10 seconds between entry of each such order on the same side of the market in a security. Members and member organizations are responsible for establishing procedures to prevent orders in a security on the same side of the market for any account in which the same person is directly or indirectly interested from being entered at intervals of less than 10 seconds.]

**[s s Commentary -----]**

**[.01** Auto-Ex eligible orders for Exchange Traded Funds ("ETFs") must be round lot, market or marketable limit orders for 2,000 shares or less received by the Exchange electronically. Orders for an account in which a market maker in ETFs registered as such on another market has an interest are ineligible for Auto-Ex for ETFs. Notice concerning Auto-Ex eligibility criteria will be provided to members periodically via Exchange circulars and will be posted on the Exchange's web site.]

**[.02** Upon the request of a specialist, the Auto-Ex Enhancements Committee ("Committee") will review and approve, disapprove or conditionally approve requests to increase the size of Auto-Ex eligible orders above 2,000 shares. The Committee will balance the interests of investors, the specialist, Registered Options Traders in the crowd,

and the Exchange in determining whether to grant a request to increase the size of Auto-Ex eligible orders above 2,000 shares. The Committee also will consider a request from a specialist to reduce the size of Auto-Ex eligible orders balancing the same interests that the Committee would consider in determining whether to increase the size of Auto-Ex eligible orders.]

[.03 Upon the request of a specialist, a Floor Governor may reduce the size of Auto-Ex eligible orders below 2,000 shares or increase the size of Auto-Ex eligible orders up to 5,000 shares if such action is appropriate in view of system problems or unusual market conditions. Any such change in the size of Auto-Ex eligible orders will be temporary and will only last until the end of the unusual market condition or the correction of the system problem.

Auto-Ex eligible orders will be routed to the specialist and will not be automatically executed in situations where the specialist in conjunction with a Floor Governor or two Floor Officials determine that quotes are not reliable and if the Exchange is experiencing communications or systems problems, "fast markets," or delays in the dissemination of quotes.

Members and member organizations will be notified when the size of Auto-Ex eligible orders is adjusted due to system problems or unusual market conditions. Members and member organizations also will be notified when the Exchange has determined that quotes are not reliable and the Exchange is experiencing communications or systems problems, "fast markets," or delays in the dissemination of quotes prior to disengaging Auto-Ex.]

[.04 When the Amex establishes the NBBO (National Best Bid or Offer), Auto-Ex will be programmed to execute eligible incoming ETF orders at the Amex Published Quote ("APQ") plus a programmable number of trading increments with respect to the Amex bid (with respect to incoming sell orders), and less a programmable number of trading increments with respect to the Amex offer (with respect to incoming buy orders). The amount of price improvement relative to the APQ will be determined by the Committee.

When the Amex does not establish the NBBO, Auto-Ex will be programmed to execute eligible incoming ETF orders at or better than the NBBO up to a specified number of trading increments relative to the APQ. Auto-Ex will execute eligible incoming orders at an improved price relative to the APQ unless a trade through would result of an away ITS participant market. If a trade through would result, the orders will be routed to the Amex specialist for execution. The extent to which Auto-Ex will better the APQ in order to match or improve the NBBO (if the Amex does not establish the NBBO) will be determined by the Committee.

Auto-Ex will be unavailable (i) with respect to incoming sell orders when the published bid on the Amex is for 100 shares, and (ii) with respect to incoming buy orders when the published offer on the Amex is for 100 shares. Auto-Ex also will be unavailable when the spread between the bid and offer on the Amex exceeds a specified minimum or maximum value. The Committee will determine the spread in the APQ at which Auto-Ex will be unavailable.

The Committee will act upon the request of a specialist and will balance the interests of investors, the specialist, Registered Options Traders in the crowd, and the

Exchange in determining (i) the amount of price improvement that will be programmed into Auto-Ex when the Amex establishes the NBBO, (ii) the extent to which Auto-Ex will better the APQ in order to match or improve the NBBO (if the Amex does not establish the NBBO), and (iii) the spread in the APQ at which Auto-Ex will be unavailable.]

[.05 Specialists and Registered Options Traders that sign-on to Auto-Ex will be automatically allocated the contra side of Auto-Ex trades for ETFs according to the following schedule:

<b>Number of ROTs Signed on to Auto-Ex in a Crowd</b>	<b>Approximate Number of Trades Allocated to the Specialist Throughout the Day ("Target Ratio")</b>	<b>Approximate Number of Trades Allocated to ROTs Signed on to Auto-Ex Throughout the Day ("Target Ratio")</b>
1	60%	40%
2 – 4	40%	60%
5 – 7	30%	70%
8 – 15	25%	75%
16 or more	20%	80%

At the start of each trading day, the sequence in which trades will be allocated to the specialist and Registered Options Traders signed-on to Auto-Ex will be randomly determined. Auto-Ex trades then will be automatically allocated in sequence on a rotating basis to the specialist and to the Registered Options Traders that have signed-on to the system so that the specialist and the crowd achieve their "target ratios" over the course of a trading session. If an Auto-Ex eligible order is greater than 100 shares, Auto-Ex will divide the trade into lots of 100 shares each. Each lot will be considered a separate trade for purposes of determining target ratios and allocating trades within Auto-Ex.]

[.06 The Committee may delegate its authority to one or more Floor Governors. The Committee will meet promptly to review a Governor's decision in the event that a Governor acts pursuant to delegated authority.]

### **Automatic Execution**

**Rule 128A.** (a) An Auto-Ex Eligible Order for an Auto-Ex Eligible Security will be executed automatically in accordance with the provisions of this rule.

(b) Definitions: Amex Published Quote (“APQ”). The Amex Published Quote is the highest bid and lowest offer disseminated by the American Stock Exchange.

Best Bid and Offer (“BBO”). The Best Bid and Offer is the highest bid and lowest offer disseminated by the national securities exchanges and facilities of national securities associations other than the Amex. Auto-Ex will disregard a bid or offer of less than 200 shares disseminated by any national securities exchange or facility of a national securities association in determining the BBO.

Auto-Ex Eligible Order. An Auto-Ex Eligible Order is a round lot or partial round lot market or marketable limit order delivered to the order book electronically. An Auto-Ex Eligible Order does not include an order update (e.g., a “cancel/replace” and “cancel/leaves” order). An Auto-Ex Eligible Order does not include an order entered into the order book by the specialist. Orders on the book may be automatically matched against incoming Auto-Ex Eligible Orders as provided in this Rule.

Auto-Ex Eligible Security. Auto-Ex Eligible Securities consist of Portfolio Depository Receipts, Index Fund Shares, Trust Issued Receipts and Nasdaq National Market Securities traded on the Exchange together with such other securities as may be designated as Auto-Ex Eligible Securities from time to time by the Exchange.

Auto-Ex. Auto-Ex is the system for automatically executing Auto-Ex Eligible Orders.

Auto-Ex Step-Up. Auto-Ex Step-Up is a functionality that allows Auto-Ex Eligible Orders to be automatically executed against the Specialist/Registered Trader Quantity at the APQ plus (in the case of a bid) or minus (in the case of an offer) a specified number of trading increments designated by the Auto-Ex Enhancements Committee necessary to match the BBO when the APQ is inferior to the BBO. Auto-Ex Step-Up is not available to orders for the proprietary account of a broker-dealer.

Auto-Ex Step-Up Amount. The Auto-Ex Step-Up Amount is the specified maximum number of trading increments necessary to attempt to match the BBO when the APQ is inferior to the BBO.

Auto-Ex Step-Up Size: The Auto-Ex Step-Up Size is the maximum size of an Auto-Ex Eligible Order that is eligible for Auto-Ex Step-Up.

Specialist/Registered Trader Quantity: The Specialist/Registered Trader Quantity is the number of shares that the specialist and registered traders in a crowd signed on to Auto-Ex will purchase or sell through Auto-Ex executions.

Available Book Quantity: The Available Book Quantity is the number of shares on the order book at the APQ plus additional orders on the book that can be executed at or within the APQ minus shares on the book priced at or within the APQ that cannot be executed by their terms (e.g., all or none orders and tick sensitive orders).

Trade Threshold: The Trade Threshold is the number of Auto-Ex trades that the specialist and crowd will execute through Auto-Ex.

Maximum Spread Value: The Maximum Spread Value is the size of the spread at which Auto-Ex is automatically turned-off because the quote is too wide.

(c) Hours of Operation: Auto-Ex will be available for an Auto-Ex Eligible Security following the opening or reopening of a security on the Exchange once a trade has occurred and a quote has been disseminated in the security. Auto Ex will be turned-off at 3:59 p.m.. For securities that trade until 4:15 p.m., Auto-Ex will be re-enabled at 4:01 p.m. and will continue to be available until 4:14 p.m..

(d) Interaction of Auto-Ex and Auction Market. (i) A bid or offer incorporated in the APQ shall not be deemed accepted by a member in the trading crowd and, as the result, no contract shall be created, until the specialist begins to enter the member's acceptance into the order book.

(ii) Auto-Ex will be turned-off on the bid or offer side of the market (as appropriate) in the event that (1) one or more brokers or registered traders in the trading crowd make a bid or offer within the APQ (a priority bid or offer), or (2) one or more brokers in the crowd make a bid or offer that is on parity with the APQ (a parity bid or offer). Auto-Ex will be turned-on again when all members signed-on to Auto-Ex in the crowd are on parity and no broker is making a parity bid or offer.

(e) Auto-Ex Enhancements Committee. The Auto-Ex Enhancements Committee will review, approve, disapprove, or conditionally approve specialist requests to take the following actions:

(i) Establish the Trade Threshold;

(ii) Establish the Specialist/Registered Trader Quantity;

(iii) Limit the size of Available Book Quantity;

(iv) Establish the Auto-Ex-Step-Up Size and Auto-Ex-Step-Up Amount in securities where there are Registered Traders in the crowd;

(v) Establish the Maximum Spread Value;

(vi) Establish the di-minimis trade through amount for securities that are listed in markets that have trade through rules.

The Committee will balance the interests of investors, the specialist, registered traders signed on to Auto-Ex, and the Exchange in considering such requests. In the event that the Committee changes one or more Auto-Ex parameters, the minutes of the Committee's meetings will state the change in market conditions, competitive environment or other circumstance(s) that caused the Committee to change the parameter(s). The Committee may delegate its authority to one or more Floor Governors. The Committee will meet promptly to review a Governor's decision in the event that a Governor acts pursuant to delegated authority.

(f) Determination of Execution Price: The price at which an Auto-Ex Eligible Order will be executed by Auto-Ex will be determined as follows:

(i) Auto-Ex will execute an Auto-Ex eligible order at the APQ (or better, as provided for in this Rule) when the APQ is equal to or better than the BBO as determined by the Exchange's order processing systems. Auto-Ex will not execute an order, and the order will be routed to the specialist for execution, if execution of the order at the APQ would result in a trade through of the BBO;

(ii) In the event that Auto-Ex Step-Up is engaged to match the BBO, Auto Ex will execute an Auto-Ex eligible order against the available Specialist/Registered

Trader Quantity at the APQ plus (in the case of a bid) or minus (in the case of an offer) the lesser of (1) the Auto-Ex Step-Up Amount, or (2) the minimum number of trading increments necessary to match the BBO where the APQ is inferior to the BBO as determined by the Exchange's order processing systems. Auto-Ex will not execute an order, and the order will be routed to the specialist for execution, if (1) execution of the order at the APQ plus (or minus) the Auto-Ex Step-Up amount would result in a trade through of the BBO, or (2) the incoming order is larger than the Auto-Ex Step-Up size;

(iii) If programmed to do so, Auto-Ex will execute an Auto-Ex eligible order at the APQ when the APQ is inferior to the BBO as determined by the Exchange's order processing systems by a specified number of trading increments (the "di-minimis trade through amount"). Auto-Ex will not execute an order, and the order will be routed to the specialist for execution, if execution of the order at the APQ would result in a trade through of the BBO by more than the di-minimis trade through amount.

Notwithstanding the foregoing, in the event that there are one or more executable limit orders on the order book on the opposite side of an Auto-Ex Eligible Order priced between the APQ, Auto-Ex will execute the incoming order against the order(s) on the order book at their limit price(s). In the event that there are one or more executable market orders in the order book on the opposite side of the incoming Auto-Ex-Eligible Order and the APQ spread is greater than the minimum trading variation, Auto-Ex will execute the incoming order against the resident market order(s) at the mid point between

the best limit bid and offer or APQ (whichever is better), and, if this mid point value is not a trading interval, the price will be rounded up to the nearest trading interval.

(g) Auto-Ex Coming out of an Order Book Freeze. During an Order Book Freeze, messages coming into the order book (e.g., orders, status requests, cancels, cancel/replaces) queue and do not enter the order book. When the Order Book Freeze ends, Auto-Ex will be re-enabled immediately if all incoming orders are on the same side of the market. Auto-Ex will not be re-enabled, however, if there are orders on both sides of the market to allow the specialist to pair-off the orders to the extent possible. Automatic execution will resume once all messages in the queue are processed.

(h) Auto-Ex Size: Auto-Ex will execute Auto-Ex Eligible Orders up to the lesser of: (1) the size displayed in the APQ plus executable orders on the book within the APQ, or (2) the sum of the remaining Specialist/Registered Trader Quantity and Available Book Quantity. Notwithstanding the foregoing, Auto-Ex trades executed by the Auto-Ex Step-Up functionality are limited to the Auto-Ex Step-Up Size.

The specialist may determine to allow the partial execution by Auto-Ex of an Auto-Ex Eligible order in the event that the incoming order is larger than the size available through Auto-Ex.

The round lot portion of a partial round lot order will be executed as if it were a round lot order and the odd lot portion of the order will be executed as if it were an odd lot order.

(i) Contra Parties to Auto-Ex Trades. Auto-Ex will first allocate the contra side to an Auto-Ex trade to the Available Book Quantity in price/time priority. Auto-Ex will then allocate any portion of the Auto-Ex Eligible Order that remains unexecuted to the

available Specialist/Registered Trader Quantity in accordance with participation percentages (“target ratios”) determined by the ETF Trading Committee.

At the start of each trading day, the sequence in which shares will be allocated to the specialist and Registered Traders signed-on to Auto-Ex will be randomly determined. Auto-Ex shares then will be automatically allocated in sequence on a rotating basis to the specialist and to the Registered Traders that have signed-on to the system so that the specialist and the crowd achieve their “target ratios” over the course of a trading session. If an Auto-Ex eligible order is greater than 100 shares, Auto-Ex will divide the trade into lots of 100 shares each. Each lot will be considered a separate trade for purposes of determining target ratios and allocating shares within Auto-Ex.

(j) Auto-Ex Unavailability. Auto-Ex will be unavailable in the following situations.

(i) Auto-Ex will not occur when the APQ is crossed with the BBO unless Auto-Ex is programmed to disregard the BBO in the case of a “di-minimis trade through” amount.

(ii) Auto-Ex will not occur when the Trade Threshold is exhausted and there is no Available Book Quantity.

(iii) Auto-Ex will not occur when the Specialist/Registered Trader Quantity is exhausted and there is no Available Book Quantity.

(iv) Auto-Ex will not occur when there is an open outgoing ITS commitment on behalf of a customer order.

(v) Auto-Ex will not occur on the Amex bid or offer (as appropriate) in the event that (1) one or more brokers or registered traders in the trading crowd make a bid

or offer within the APQ (a priority bid or offer), or (2) one or more brokers in the crowd make a bid or offer that is on parity with the APQ (a parity bid or offer).

Auto-Ex will be turned-on again when all members signed-on to Auto-Ex in the crowd are on parity and no broker is making a parity bid or offer.

(vi) Auto-Ex will not occur on the bid or offer (as appropriate) in the event that the APQ on that side of the market is for less than 200 shares.

(vii) Auto-Ex will not occur when there is insufficient size to fill the entire incoming order and partial executions of incoming Auto-Ex Eligible Orders are disallowed.

(viii) Auto-Ex will not occur when the order book on the Amex is locked or crossed with the APQ.

(ix) Auto-Ex will not occur with respect to an incoming Auto-Ex Eligible All Or None or Institutional Order in the event that there is insufficient size to execute the order according to its terms.

(x) Auto-Ex will not occur if the execution of the incoming order would elect a stop order on the order book.

(xi) Auto-Ex will not occur if the specialist is in the process of executing an order in the security.

(xii) Auto-Ex will not occur in one or more securities when the specialist, in conjunction with a Floor Governor or two Floor Officials, determine(s) that (1) quotes are not reliable, (2) the Exchange is experiencing communications or systems problems, "Unusual Market Conditions" as described in Amex Rule 115, or delays in the dissemination of quotes, or (3) the market(s) where the underlying

securities trade (or Nasdaq with respect to Nasdaq National Market Securities) are experiencing communications or systems problems, "Unusual Market Conditions" as described in SEC Rule 11Ac1-1, or delays in the dissemination of quotes.

(xiii) Auto-Ex will not occur if it would cause a trade to occur through the price of an all or none order on the book.

(xiv) Auto-Ex will not occur if there are orders on both sides of the market when the order book comes out of a Freeze condition to allow the specialist to pair-off the orders.

(xv) Auto-Ex will not occur if the spread exceeds the Maximum Spread Value.

Auto-Ex Eligible Orders that are not automatically executed will be routed to the specialist for handling.

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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, as amended, 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. 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

On June 19, 2001, the Commission approved the Exchange's proposal to permit the automatic execution of orders for Exchange Traded Funds ("ETFs") on a six-month

pilot program basis.<sup>5</sup> Since that time, the Exchange has renewed the ETF Auto-Ex pilot at six month intervals. On April 23, 2003, the Commission approved the Exchange's temporary Rule 118A-T to permit the automatic execution of orders for Nasdaq National Market securities traded on the Exchange pursuant to unlisted trading privileges.<sup>6</sup> The Exchange intended both the ETF and Nasdaq Auto-Ex initiatives to be interim steps that would be superseded by enhanced Auto-Ex technology. The current proposal embodies the Exchange's enhanced Auto-Ex technology which, unlike the earlier systems, would permit Auto-Ex to occur against orders on the book.<sup>7</sup>

To implement the enhanced Auto-Ex technology, the Exchange is proposing to rescind both of its current Auto-Ex for equity rules: Rule 118A-T (Automatic Execution for Nasdaq National Market Securities (Temporary)) and Rule 128A (Automatic Execution for Exchange Traded Funds and Trust Issued Receipts). In their place, the Exchange is proposing to adopt new Rule 128A (Automatic Execution). The proposed new rule would govern automatic execution of both ETFs and Nasdaq stocks traded on the Exchange. According to the Exchange, it does not intend at this time to extend the proposed new Auto-Ex procedures to other Amex traded equities although, according to

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<sup>5</sup> See Securities Exchange Act Release No. 44449 (June 19, 2001), 66 FR 33724 (June 25, 2001) (approving File No. SR-Amex-2001-29).

<sup>6</sup> See Securities Exchange Act Release No. 47728 (April 23, 2003), 68 FR 23348 (May 1, 2003) (SR-Amex-2003-16).

<sup>7</sup> The Commission notes that Amex's proposal would not be sufficient for Amex to be considered an "automated order execution facility," as defined in Rule 600(b)(3) of proposed Regulation NMS because, among other things, it would not provide for an immediate automated response to all incoming subject orders. See Securities Exchange Act Release No. 49325 (February 26, 2004), 69 FR 11126 at 11203 (March 9, 2004).

the Exchange, it may do so in the future. The proposed new rule would not affect Auto-Ex for options.

Paragraph (a) of the proposed new rule would state the general principle that automatic execution would be governed by the provisions of the rule. It would state that an Auto-Ex Eligible Order for an Auto-Ex Eligible Security would be executed automatically in accordance with the terms of the rule.

Paragraph (b) of the proposed new rule would define terms used in the rule. “Amex Published Quote” (“APQ”) would be defined as the highest bid and lowest offer disseminated by the American Stock Exchange. The “Best Bid and Offer” (“BBO”) would be defined as the highest bid and lowest offer disseminated by the national securities exchanges and facilities of national securities associations other than the Amex. The definition of “BBO” would provide that Auto-Ex would disregard a bid or offer of less than 200 shares disseminated by any national securities exchange or facility of a national securities association in determining the BBO since 100 share quotes may indicate that the quote is exhausted at that price level and are not subject to protection under the ITS Trade Through Rule.<sup>8</sup>

Paragraph (b) of the proposed new rule would define “Auto-Ex Eligible Order” as a round lot or partial round lot market or marketable limit order delivered to the order book electronically. The definition would provide that an Auto-Ex Eligible Order would not include an order update (e.g., a “cancel/replace” and “cancel/leaves” order). The definition also would provide that an order, once it is on the book, would be able to be automatically matched against an incoming Auto-Ex Eligible Order. The definition

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<sup>8</sup> See, e.g., Amex Rule 236(b)(3)(A).

would further provide that an agency order entered into the order book by the specialist would not be eligible for Auto-Ex.<sup>9</sup> “Auto-Ex Eligible Securities” would be defined by the proposed new rule as Portfolio Depository Receipts, Index Fund Shares, Trust Issued Receipts and Nasdaq National Market Securities traded on the Exchange.

Paragraph (b) of the proposed new rule would define terms used in connection with the “Step-Up” functionality of Auto-Ex. “Auto-Ex Step-Up” would be defined as a functionality that allows Auto-Ex Eligible Orders to be automatically executed at the APQ plus (in the case of a bid) or minus (in the case of an offer) a specified number of trading increments designated by the Auto-Ex Enhancements Committee<sup>10</sup> necessary to match the BBO when the APQ is inferior to the BBO. The definition would provide that Auto-Ex Step-Up would not be available to orders for the principal account of a broker-dealer since the purpose of the functionality would be to attract customer orders to the Exchange. The “Auto-Ex Step-Up Amount” would be defined as the specified number of trading increments necessary to attempt to match the BBO when the APQ is inferior to the BBO. “Auto-Ex Step-Up Size” would be defined as the maximum size of an Auto-Ex Eligible Order eligible for Auto-Ex Step-Up.

Paragraph (b) of the proposed new rule would define terms used in connection with determining the size and number of orders that would be able to be executed by Auto-Ex. “Specialist/Registered Trader Quantity” would be defined as the number of shares that the specialist and registered traders in a crowd signed on to Auto-Ex would

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<sup>9</sup> Specialists may not place orders for their principal account on the order book.

<sup>10</sup> The Auto-Ex Enhancements Committee consists of the Exchange’s four Floor Governors and the Chairmen (or their designees) of the Specialists Association, Options Market Makers Association and the Floor Brokers Association.

purchase or sell through Auto-Ex executions. “Available Book Quantity” would be defined as the number of shares on the order book at the APQ plus additional orders on the book that would be able to be executed at or within the APQ minus shares on the book priced at or within the APQ that would not be able to be executed by their terms (e.g., all or none orders and tick sensitive orders). “Trade Threshold” would be defined as the number of Auto-Ex trades that the specialist and crowd would execute through Auto-Ex. “Maximum Spread Value” would be the size of the spread at which Auto-Ex would be automatically turned-off because the quote is too wide.

Paragraph (c) of the proposed new rule would define the hours when Auto-Ex would be available. It would provide that Auto-Ex would be available for an Auto-Ex Eligible Security following the opening or reopening of a security on the Exchange once a trade has occurred and a quote has been disseminated in the security. It would further provide that Auto Ex would be turned off at 3:59 p.m. to facilitate the execution of at-the-close orders under the Exchange’s closing procedures.<sup>11</sup> For securities that trade until 4:15 p.m., the proposed new rule would provide that Auto-Ex would be turned on again at 4:01 p.m. and would continue to be available until 4:14 p.m. when it would be turned off for the rest of the day to facilitate the execution of at-the-close orders in securities that trade until 4:15 p.m. under the Exchange’s closing procedures.

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<sup>11</sup> See Amex Rules 109(d), Commentary .02 to Rule 109, Commentary .01 to Rule 118, 131(e), Commentaries .02 and .03 to Rule 131, Rule 156(c), and Commentary .01 to Rule 156. See also Securities Exchange Act Release Nos. 41877 (September 14, 1999), 64 FR 51566 (September 23, 1999) (SR-Amex-99-32); 40123 (June 24, 1998), 63 FR 36280 (July 2, 1998) (SR-Amex-98-10); 35660 (May 2, 1995), 60 FR 22592 (May 8, 1995) (SR-Amex-95-09); and 29312 (June 14, 1991), 56 FR 28583 (June 21, 1991) (SR-Amex-90-32).

Paragraph (d) of the proposed new rule would set forth principles of how Auto-Ex would operate in conjunction with the Exchange's "open outcry" auction market. Sub-paragraph (i) would provide that a bid or offer incorporated in the APQ would not be deemed accepted by a member in the trading crowd, and the acceptance, therefore, would not create a binding contract, until the specialist began to enter the member's acceptance into the order book. Amex believes that this would address situations where an order on the book establishes the APQ, and a member in the crowd (a broker, registered trader, or specialist) verbally accepts the bid or offer represented by the order on the book (thus forming a contract under the Exchange's auction market rules<sup>12</sup>), but an Auto-Ex Eligible Order takes the bid or offer before the specialist can process the member's acceptance. Amex believes that sub-paragraph (i) would address this potential double liability scenario by providing that a contract is not formed until the specialist begins to enter the member's acceptance into the book. At this point, messages would not be able to enter the book until the specialist finishes entering the acceptance, and an Auto-Ex Eligible Order would not be able to take the bid or offer ahead of the member who had previously accepted the bid or offer. According to Amex, subparagraph (i) thus is intended to limit the possibility of double liability in securities subject to Auto-Ex that would exist if a contract were formed upon the verbal acceptance of a bid or offer.

Sub-paragraph (ii) of Paragraph (d) would provide that Auto-Ex would be turned off on the bid or offer side of the market (as appropriate) in the event that one or more

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<sup>12</sup> Amex Rule 128 currently provides that: "All bids and offers made and accepted in accordance with these Rules shall constitute binding contracts but shall be subject to the exercise by the Board of Governors of the powers in respect thereto vested in said Board by the Constitution of the Exchange and the Rules of the Exchange."

brokers or registered traders in the trading crowd make a bid or offer within the APQ (a priority bid or offer). This would allow a price improving member in the crowd with a priority bid or offer to obtain an execution at his or her improved price without having an Auto-Ex Eligible Order trade through the priority bid or offer. Sub-paragraph (ii) of Paragraph (d) also would provide that Auto-Ex would be turned off on the bid or offer side of the market (as appropriate) in the event that one or more brokers in the crowd have a bid or offer on parity with the APQ (a parity bid or offer). According to Amex, this would allow brokers on parity with the specialist and traders in the crowd to participate on trades where they are entitled to participate. As described within, Auto-Ex would be re-enabled when all members signed-on to Auto-Ex are on parity and no broker is making a parity bid or offer.

Paragraph (e) of the proposed rule would describe the role of the Auto-Ex Enhancements Committee in the operation of Auto-Ex. It would provide that the Committee would review, approve, disapprove, or conditionally approve specialist requests to take the following actions: (i) establish the Trade Threshold, (ii) establish the Specialist/Registered Trader Quantity, (iii) limit the size of Available Book Quantity, (iv) establish the Auto-Ex-Step-Up Size and Auto-Ex-Step-Up Amount where there are Registered Traders in the crowd, (v) establish the Maximum Spread Value, and (vi) establish the de minimis trade through amount for securities that are listed in markets that have trade through rules. The proposed new rule would require the Committee to balance the interests of investors, the specialist, registered traders signed on to Auto-Ex, and the Exchange in considering such requests. In the event that the Committee were to change one or more Auto-Ex parameters, the minutes of the Committee's meetings would state

the change in market conditions, competitive environment or other circumstances that caused the Committee to change the parameter(s) in question. The proposed rule also would provide that the Committee would be able to delegate its authority to one or more Floor Governors, and that the Committee would meet promptly to review a Governor's decision in the event that a Governor were to act pursuant to delegated authority.

According to Amex, the Auto-Ex Enhancement Committee has existed since 2001 and has been responsible for reviewing Auto-Ex parameters for both Amex traded options, ETFs and Nasdaq UTP.<sup>13</sup> According to Amex, the Committee consists of all Floor Governors and the heads of the three floor associations (or their designees). It has been the Exchange's experience that the Auto-Ex parameters, once set, are changed infrequently.

Paragraph (f) of the proposed new rule would describe how the price of Auto-Ex executions would be determined. Except as described below, Auto-Ex would execute an Auto-Ex eligible order at the APQ when the APQ is equal to or better than the BBO as determined by the Exchange's order processing systems. Auto-Ex would not execute an order, and the order would be routed to the specialist for execution, if execution of the order at the APQ would result in a trade through of the BBO except in cases where the "de minimis trade-through" functionality would be used as described below.

In the event that Auto-Ex Step-Up was engaged, Auto Ex would execute an Auto-Ex eligible order at the APQ plus (in the case of a bid) or minus (in the case of an offer)

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<sup>13</sup> The role of the Auto-Ex Enhancements Committee is described in Commentary .01 to Amex Rule 933 (listed options), Commentary .02 to Amex Rule 128A (ETFs), and Amex Rule 118A-T(e) (Nasdaq securities traded on an unlisted basis).

the maximum Auto-Ex Step-Up Amount necessary to match the BBO where the APQ would be inferior to the BBO as determined by the Exchange's order processing systems. Auto-Ex would not execute an order, and the order would be routed to the specialist for execution, if execution of the order at the APQ plus the maximum Auto-Ex Step-Up amount would result in a trade through of the BBO or the incoming order would be larger than the Auto-Ex Step-Up size.

Under the proposed de minimis trade through functionality, Auto-Ex would be able to execute an Auto-Ex eligible order at the APQ when the APQ is inferior to the BBO as determined by the Exchange's order processing systems by a specified number of trading increments (the "de minimis trade through amount"). Auto-Ex would not execute an order, and the order would be routed to the specialist for execution, if execution of the order at the APQ would result in a trade through of the BBO by more than the de minimis trade through amount. The de minimis trade through functionality currently only would be used for SPY, DIA and QQQ and Nasdaq National Market Securities.

Paragraph (f) of the proposed rule would provide that if there were one or more executable limit orders on the order book priced between the APQ on the opposite side of an incoming Auto-Ex Eligible Order, Auto-Ex would execute the incoming order against the order(s) on the order book at their limit price(s) in price time priority. In the event that there were one or more executable market orders in the order book on the opposite side of the incoming Auto-Ex-Eligible Order and the APQ spread was greater than the minimum trading variation, Auto-Ex would execute the incoming order against the resident market order(s) at the mid point between the best limit bid and offer or APQ

(whichever is better) in price time priority. If this mid point value was not a trading interval, the price would be rounded up to the nearest trading interval. According to Amex, this functionality would ensure that customer orders would be able to automatically interact with one another to the greatest extent possible.

Paragraph (g) of the proposed rule would discuss the availability of Auto-Ex in a security when the security is coming out of an Order Book Freeze. According to Amex, during the time of an Order Book Freeze, messages being sent to the order book (e.g., orders, status requests, cancels, cancel/replaces) queue and do not enter the order book.<sup>14</sup> When the Order Book Freeze ends, Auto-Ex would be re-enabled immediately if all incoming orders were on the same side of the market. Auto-Ex would not be re-enabled, however, if there were orders on both sides of the market. This would allow the specialist to pair-off the incoming orders so that they would be able to interact to the greatest extent possible. Automatic execution would resume once all messages in the queue are processed.

Paragraph (h) of the proposed rule would discuss Auto-Ex size. It would provide that Auto-Ex would execute Auto-Ex Eligible Orders up to the lesser of: (1) the size displayed in the APQ plus executable orders on the book within the APQ, or (2) the sum of the remaining Specialist/Registered Trader Quantity and Available Book Quantity. As previously noted, Auto-Ex trades executed by the Auto-Ex Step-Up functionality would be limited to the Auto-Ex Step-Up Size.

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<sup>14</sup> According to Amex, messages in the queue are not visible to the specialist until the Freeze ends and the messages enter the book.

Paragraph (h) of the proposed rule would provide that the specialist would be able to determine to allow the partial execution by Auto-Ex of an Auto-Ex Eligible order in the event that the incoming order was larger than the size available through Auto-Ex. Paragraph (h) also would provide that the round lot portion of a partial round lot order would be executed as if it were a round lot order, and the odd lot portion of the order would be executed as if it were an odd lot order.

Paragraph (i) of the proposed rule would discuss the allocation of the other side of Auto-Ex trades either to orders on the book or to the specialist and registered traders signed-on to Auto-Ex. Under the proposed Rule, Auto-Ex would first allocate the contra side to an Auto-Ex trade to the Available Book Quantity in price/time priority. Auto-Ex would then allocate any portion of the Auto-Ex Eligible Order that remained unexecuted to the available Specialist/Registered Trader Quantity in accordance with participation percentages (“target ratios”) determined by the ETF Trading Committee.<sup>15</sup>

At the start of each trading day, the sequence in which shares would be allocated to the specialist and Registered Traders signed-on to Auto-Ex would be randomly determined. Auto-Ex trades then would be automatically allocated in sequence on a rotating basis to the specialist and to the Registered Traders that have signed-on to the

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<sup>15</sup> The ETF Trading Committee was proposed in File No. SR-Amex-2002-35. See Securities Exchange Act Release Nos. 49058 (January 12, 2004), 69 FR 2754 (January 20, 2004) (notice); and 49396 (March 11, 2004), 69 FR 12719 (March 17, 2004) (approval order). The Committee is composed of the Exchange’s four Floor Governors, the Chairmen (or their designee) of the Specialists Association, the Options Market Makers Association and the Floor Brokers Association and three members of the Exchange’s senior staff. Since Nasdaq National Market Securities traded on the Amex are not traded by registered traders, the Specialist/Registered Trader Quantity with respect to Nasdaq National Market Securities traded on the Amex would consist solely of specialist interest.

system so that the specialist and the crowd achieve their “target ratios” over the course of a trading session. If an Auto-Ex eligible order was greater than 100 shares, Auto-Ex would divide the trade into lots of 100 shares each. Each lot would be considered a separate trade for purposes of determining target ratios and allocating shares within Auto-Ex.

Paragraph (j) of the proposed Rule would discuss the situations in which Auto-Ex would be unavailable and would state that orders would be routed to the specialist for execution in these situations. Subparagraph (i) of paragraph (j) would provide that Auto-Ex would not occur when the APQ is crossed with the BBO unless (as discussed above) Auto-Ex was programmed to disregard the BBO in the case of a “de minimis trade through” amount. Auto-Ex would continue to occur when the APQ is locked with the BBO at the “lock” price. Subparagraph (ii) would provide that Auto-Ex would not occur when the Trade Threshold is exhausted and there is no Available Book Quantity. Subparagraph (iii) would provide that Auto-Ex would not occur when the Specialist/Registered Trader Quantity is exhausted and there is inadequate Available Book Quantity.

Subparagraph (iv) would provide that Auto-Ex would not occur when there is an open outgoing ITS commitment on behalf of a customer order. This would allow the specialist to send a commitment to an away market on behalf of a customer order without the customer order being executed automatically while the specialist is waiting for a response to the outgoing commitment. This feature would not apply to Nasdaq National Market Securities. Subparagraph (v) provides that Auto-Ex would not occur on the bid or offer (as appropriate) in the event that (1) one or more brokers or registered traders in

the trading crowd have made a bid or offer within the APQ (a priority bid or offer), or (2) one or more brokers in the crowd have made a bid or offer that is on parity with the APQ (a parity bid or offer). This would allow a member in the crowd that improves the APQ to execute at the improved price without having an Auto-Ex trade occur through the improved bid or offer, and it would allow brokers on parity with the specialist and traders in the crowd to participate on trades where they are entitled to participate. Subparagraph (vi) would provide that Auto-Ex would not occur on the bid or offer (as appropriate) in the event that the APQ on that side of the market was for less than 200 shares. According to Amex, a quote of 100 shares may signify that the quote is exhausted at that price level and is not subject to protection under the ITS Trade Through Rule.

Subparagraph (vii) would provide that Auto-Ex would not occur when there is insufficient size to fill the entire incoming Auto-Ex Eligible Order and partial executions of incoming Auto-Ex Eligible Orders are disallowed. Subparagraph (viii) would provide that Auto-Ex would not occur when the order book on the Amex is locked or crossed with the APQ. This would prevent automatic executions in faulty markets.

Subparagraph (ix) would provide that Auto-Ex would not occur with respect to an incoming Auto-Ex Eligible All or None or Institutional Order in the event that there is insufficient size to execute the All or None or Institutional Order according to its terms.

Subparagraph (x) would provide that Auto-Ex would not occur if the execution of the incoming order would elect one or more stop orders on the order book to prevent the automatic election of stop orders.

Subparagraph (xi) would provide that Auto-Ex would not occur if the specialist is in the process of executing an order in the security. As previously discussed, this would

prevent double liability and allow the specialist to maintain an orderly market by executing trades in proper time sequence in accordance with the rules of the auction market. Subparagraph (xii) would provide that Auto-Ex would not occur in one or more securities when the specialist, in conjunction with a Floor Governor or two Floor Officials, determine(s) that (1) quotes are not reliable, (2) the Exchange is experiencing communications or systems problems, “Unusual Market Conditions” as described in Amex Rule 115, or delays in the dissemination of quotes, or (3) the market(s) where the underlying securities trade are experiencing communications or systems problems, “Unusual Market Conditions” as described in Commission Rule 11Ac1-1, or delays in the dissemination of quotes. The Exchange believes that Auto-Ex should not occur in these circumstances since the APQ and BBO may not correctly reflect the forces of supply and demand. Subparagraph (xiii) would provide that Auto-Ex would not occur if it would cause a trade to occur through the price of an all or none order on the book. Subparagraph (xiv) would provide that Auto-Ex would not occur if there are orders on both sides of the market when the order book comes out of a freeze condition. This would allow the specialist to pair-off the orders so that they can interact. Subparagraph (xv) would provide that Auto-Ex would not occur if the spread in the security exceeds the Maximum Spread Value.

The Exchange also is proposing to amend Rule 118 to create a new type of limit order, called an “institutional order” that would be used for customer orders of 10,000 shares or more in Nasdaq National Market Securities. This new order (which is not available for other securities traded on the Exchange) must be executed automatically in full at one price. If it is not executed automatically in full at one price, it is to be routed

to the specialist for execution and may be partially executed. Unlike an all or none order, an institutional order will have standing on the book since it may be executed in part once it is on the book.

The Exchange anticipates that it may require up to three months to complete the implementation of the new Auto-Ex technology to all affected securities following Commission approval of this proposal.

## 2. Statutory Basis

The Amex believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act<sup>16</sup> in general and furthers the objectives of Section 6(b)(5)<sup>17</sup> in particular in that it is 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; and is not designed to permit unfair discrimination between customers, issuers, brokers and dealers.

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

The Exchange believes that the proposed rule change, as amended, will impose no burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

<sup>17</sup> 15 U.S.C. 78f(b)(5).

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 by the Exchange on the proposed rule change, as amended.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, as amended, or
- B. institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-Amex-2004-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 the filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-2004-04 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).

Room. Copies of the filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-2004-04 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Margaret H. McFarland  
Deputy Secretary

Action as set forth or recommended herein  
APPROVED pursuant to authority delegated by  
the Commission under Public Law 87-592.

For: Division of Market Regulation

By: \_\_\_\_\_  
\_\_\_\_\_  
(dated)

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