

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49892; File No. SR-Amex-2004-46)

June 18, 2004

Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to an Extension of Automatic Execution for Exchange Traded Funds

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 June 7, 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 the Amex has prepared. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

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

The Amex seeks an extension of Amex Rule 128A to continue its pilot program for the automatic execution of orders for Exchange Traded Funds until the implementation of the new technology embodied in SR-Amex 2004-04 or six months, whichever is sooner.

The text of the proposed rule change is available at the Office of the Secretary, the Amex and at the Commission.

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 its proposal and discussed any comments it had received

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

regarding the proposal. 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.³ On December 20, 2001, June 17, 2002, December 30, 2002, July 17, 2003, and December 5, 2003, the Exchange extended the pilot for consecutive terms of six months.⁴ The Exchange now seeks to extend the pilot until the implementation of the new technology embodied in SR-Amex 2004-04 or another six months, whichever is sooner.

Since 1986, the Exchange has had an automatic order execution feature ("Auto-Ex") for eligible orders in listed options. The Chicago Board Options Exchange, Inc., the Philadelphia Stock Exchange, Inc., and the Pacific Stock Exchange, Inc. established similar automatic option order execution features at about the same time as the Amex, and the newest options exchange, the International Stock Exchange, Inc., also features

³ See, Securities Exchange Act Release No. 34-44449 (June 19, 2001), 66 FR 33724 (June 25, 2001), approving File No. SR-Amex-2001-29.

⁴ See, Securities Exchange Act Release Nos. 45176, 66 FR 67582 (December 31, 2001); 46085, 67 FR 42836 (June 25, 2002); 47105, 68 FR 592 (January 6, 2003); and 48126, 68 FR 41189 (July 10, 2003) (notices of filing and immediate effectiveness of File Nos. SR-Amex-2001-105, SR-Amex-2002-42, SR-Amex-2002-99, and SR-Amex-2003-61, 48964, 68 FR 75664 (December 31, 2003) SR-Amex-2003-107, respectively).

automatic order execution. Auto-Ex, accordingly, has been a standard feature of the options markets for a number of years.

In 1993, the Amex commenced trading Standard and Poor's Depository Receipts® ("SPDRs®"), the first of the Exchange's increasingly popular ETFs. ETFs are individual securities that represent a fractional, undivided interest in a portfolio of securities. Currently, more than 100 ETFs are listed on the Amex. Like options, ETFs are a derivative security. Their price is a function of the value of the portfolio of securities underlying the ETF. Thus, as is the case with options, the Exchange is not the price discovery market for ETFs; the price discovery market is the market or markets where the underlying securities trade.

The Exchange is now proposing to extend its current Auto-Ex technology for an additional six months to ETFs listed under Amex Rules 1002, 1002A, and 1202. This will provide investors that send eligible orders to the Exchange with faster executions than they otherwise would receive. Many investors desire rapid executions in trading securities that are priced derivatively since the value of the underlying instruments may fluctuate during order processing. The Amex, moreover, will incorporate a price improvement algorithm into Auto-Ex for ETFs. This will provide investors with better execution prices on their orders. The price improvement algorithm works in the following manner.

When the Amex establishes the National Best Bid or Offer ("NBBO"), 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, and less a programmable number of trading increments in the case of the

Amex offer. For example, if the Amex Published Quote were 90.10 to 90.20, and the APQ constituted the NBBO, incoming sell orders might be automatically executed at 90.12 (the Amex bid plus two ticks) and incoming buy orders might be executed at 90.18 (the Amex offer less two ticks). If the Amex did not constitute the NBBO, Auto-Ex would execute eligible orders unless a trade through would result from an away ITS participant market. If a trade through would result, the order would be routed to the specialist for electronic processing through the Amex electronic order book.⁵ Using the example above, if the Amex bid were 90, and an away ITS market were bidding 90.01, an incoming sell order would be automatically executed on the Amex at 90.02. (Recall that Auto-Ex in the example is programmed to execute the order at the Amex bid plus two ticks.) Continuing the example, if the away market were bidding 90.02, an incoming sell order would be automatically executed on the Amex at 90.02 (matching the away market). If the away market were bidding 90.03, the incoming sell order would not be automatically executed. Instead, it would be routed to the specialist for electronic processing through the electronic order book.

The amount of price improvement will be determined by the Auto-Ex Enhancements Committee (“Committee”) upon the request of a specialist and may differ among ETFs. The Committee consists of the Exchange’s four Floor Governors and the Chairmen (or their designees) of the Specialists Association, Options Market Makers

⁵ Once an order that is Auto-Ex eligible is sent to the Exchange, the person that initiated the order has no control over its execution. This is the case regardless of whether the order is executed by Auto-Ex or is executed by the specialist because Auto-Ex is unavailable. If the order is routed to the specialist for handling because Auto-Ex is unavailable, the specialist does not know if the order is for the account of a broker-dealer or for the account of a customer. This information is in the Exchange’s order processing systems and is unavailable to the specialist.

Association and the Floor Brokers Association. The Exchange anticipates that the amount of price improvement will vary among securities based upon factors such as the width of the spread, the volatility of the underlying basket of securities, and liquidity of available hedging vehicles. The amount of price improvement may be adjusted intra-day. Auto-Ex for ETFs with price improvement will be unavailable when the spread is at a specified minimum and maximum variation that may be adjusted security to security. The Committee will determine, upon the request of a specialist, the minimum and maximum spreads at which Auto-Ex will be unavailable.

Auto-Ex will be unavailable with respect to incoming sell orders when the Amex bid is for 100 shares. Auto-Ex will similarly be unavailable with respect to incoming buy orders when the Amex offer is for 100 shares. Orders that are otherwise Auto-Ex eligible orders also 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 determines that quotes are not reliable and 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 Exchange has determined that quotes are not reliable prior to disengaging Auto-Ex.

Specialists and Registered Options Traders that sign-on to the system will be automatically allocated the contra side of Auto-Ex trades for ETFs. Due to the automatic price improvement feature, the specialist and Registered Options Traders that sign onto Auto-Ex for ETFs will be deemed to be on parity for purposes of allocating the contra side of ETF Auto-Ex trades. The Exchange proposes to use the following methodology for the allocation of the contra side to Auto-Ex ETF trades.

Number of ROTs Signed on to Auto-Ex in a Crowd	Approximate Number of Trades Allocated to the Specialist Throughout the Day (“Target Ratio”)	Approximate Number of Trades Allocated to ROTs Signed on to Auto-Ex Throughout the Day (“Target Ratio”)
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.

Round lot orders delivered to the post electronically for 2,000 shares or less are eligible for Auto-Ex for ETFs. 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. If orders for such market makers were eligible for Auto-Ex with price improvement, Amex specialists and Registered Options Traders would be unable to make markets with the proposed liquidity for other investors. (Orders for Amex Registered Traders are ineligible for Auto-Ex for ETFs pursuant to Commentaries .04 and .05 to Amex Rule 111 and Amex Rule 950(c).)

The specialist may request the Exchange to increase the maximum size of Auto-Ex eligible orders. Such requests will be reviewed by the Committee, which will approve, disapprove or conditionally approve such requests. 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. The Committee also will consider requests from the specialist or Registered Options Traders to reduce the size of Auto-Ex eligible orders, balancing the same interests that it would consider in reviewing a request to increase the size of Auto-Ex eligible orders. The Committee, however, may not reduce the size of Auto-Ex eligible orders below 2,000 shares. In the event of system problems or unusual market conditions, 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. Any such change will be temporary and will only last until the end of the unusual market condition or the correction of the system problem. 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.

The Chairman and Vice Chairman of the Exchange, acting jointly, will

determine which ETFs are Auto-Ex eligible.

2. Statutory Basis

The Amex believes the proposed rule change is consistent with Section 6(b) of the Act,⁶ in general, and with Section 6(b)(5)⁷ 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. The Amex believes that the proposed rule change will allow the Auto-Ex for ETFs pilot program to continue for an additional six months. The Amex further believes that the proposal will facilitate the comparison and settlement of trades since Auto-Ex transactions result in “locked-in” trades.

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

The Amex does not believe that the proposed rule change will impose any burden on competition.

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

The Amex neither solicited nor received written comments with respect to the

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

proposed rule change.

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

Because the foregoing proposed rule change does not:

(i) significantly affect the protection of investors or the public interest;

(ii) impose any significant burden on competition; and

(iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act⁸ and Rule 19b-4(f)(6) thereunder.⁹ At any time within 60 days of the filing of the 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 furtherance of the purposes of the Act.

A proposed rule change filed under Rule 19b-4(f)(6)¹⁰ normally does not become operative prior to 30 days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Amex has requested that the Commission waive both the five-day notice and the 30-day operative delay specified in Rule 19b-4(f)(6)(iii).¹¹

The Commission believes that waiving the five-day notice and the 30-day

⁸ 15 U.S.C. 78s(b)(3)(A).

⁹ 17 CFR 240.19b-4(f)(6).

¹⁰ 17 CFR 240 19b-4(f)(6).

¹¹ 17 CFR 240 19b-4(f)(6)(iii).

operative delay is consistent with the protection of investors and the public interest¹² because it will allow the Amex to continue to the pilot without interruption. For these reasons, the Commission designates the proposed rule change as effective and operative on June 7, 2004. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such proposed 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 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 (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Amex-2004-46 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Amex-2004-46. This file number should be included on the subject line if e-mail is used. To help the Commission process

¹² For purposes of waiving the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C 78c(f).

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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2004-46 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.¹³

Margaret H. McFarland
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).