

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-50999; File No. SR-Amex-2003-90)**

**January 7, 2005**

**Self-Regulatory Organizations; Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto by American Stock Exchange LLC Relating to the Amendment of Exchange Rule 153**

**I. Introduction**

On October 9, 2003, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), 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> a proposed rule change to amend Amex Rule 153 relating to the creation of an electronic order audit trail. On December 15, 2004, the Exchange submitted Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the Federal Register on December 22, 2004 for a 15-day comment period, which expired on January 6, 2005.<sup>3</sup> This order approves the proposed rule change, and Amendment No. 1 thereto, on an accelerated basis.

**II. Background**

The proposed rule change is intended to fulfill certain of the undertakings contained in an order issued by the Commission relating to the settlement of an enforcement action against the Amex, Chicago Board Options Exchange, Inc., Pacific Exchange, Inc., and Philadelphia Stock Exchange, Inc. (collectively "Options Exchanges") for failure to comply with their own rules and to enforce compliance with their own rules by their members and persons associated with their

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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 Securities Exchange Act Release No. 50866 (December 16, 2004), 69 FR 76798.

members<sup>4</sup> as is required by Section 19(g) of the Act.<sup>5</sup> The Order found that the Options Exchanges impaired the operations of the options market by: (1) following a course of conduct under which they refrained from multiply listing a large number of options; and (2) inadequately discharging their obligations as self-regulatory organizations by failing adequately to enforce compliance with (a) certain of their rules, including order handling rules, that promote competition as well as investor protection, and (b) certain of the rules prohibiting anticompetitive conduct, such as harassment, intimidation, refusals to deal and retaliation directed at market participants who sought to act competitively. In addition, the Commission found that the Options Exchanges failed to enforce compliance with their trade reporting rules, which promote transparency of the market and facilitate surveillance and enforcement of other exchange rules and the federal securities laws.

As part of the Order, the Options Exchanges agreed to, and were ordered to comply with, a variety of undertakings. Among other things, they agreed to, and were ordered to, design and implement an accurate, time-sequenced, consolidated options audit trail system (“COATS”) that would enable the Options Exchanges to reconstruct markets promptly, effectively surveil them, and enforce order handling, firm quote, trading reporting and other rules. The Options Exchanges were required to complete this undertaking in five phases. The Options Exchanges have completed the first four phases. The final phase of the undertaking to implement COATS requires that each exchange incorporate into its audit trail all non-electronic orders. This proposed rule change addresses that aspect of the undertaking.

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<sup>4</sup> See Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Sanctions, Securities Exchange Act Release No. 43268 (September 11, 2000) and Administrative Proceeding File 3-10282 (the “Order”).

<sup>5</sup> 15 U.S.C. 78s(g).

### **III. Description of Proposed Rule Change**

Amex Rule 153(b) currently requires members and member organizations to systematize “immediately upon receipt” orders, and modifications or cancellations of orders, “that are eligible for input into the Exchange’s electronic order processing facilities” if such orders are not already systematized in the Exchange’s electronic order processing facilities.<sup>6</sup> To comply with the COATS standard for an accurate time sequencing of option orders, transactions and quotations, in the instant filing, the Exchange proposes that members and member organizations would be required to systematize, prior to representation, either in BARS or in the Order Ticket enhancement to BARS described below, those options orders and modifications and cancellations of such orders that are not already systematized in an Amex system. The obligation to systematize orders prior to representation would commence on January 10, 2005.

In the case of an order that is not systematized when it reaches the Exchange, Amex proposes that a floor broker or a broker’s clerk would be required to systematize the order by: (1) opening an Order Entry Template (“OET”) on the Exchange’s BARS booth or hand held terminal; (2) entering the order terms into the OET; and (3) transmitting the order to the Amex Order File (“AOF”). The first keystroke in the OET would be captured by the Exchange’s systems as the time of order receipt. Brokers and their clerks also would be required to enter information relating to any modification, cancellation or execution of an order into BARS. The Exchange would then incorporate order and execution information in the AOF into the COATS file.

In addition to entering a non-system order directly into BARS, the Amex has designed an enhancement to the BARS system (called “Order Ticket”) to facilitate order systemization by

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<sup>6</sup> See Securities Exchange Act Release No. 45794 (April 22, 2002), 67 FR 20849 (April 26, 2002).

floor brokers and their clerks. The Exchange anticipates that the Order Ticket enhancement will be available by the end of the first quarter of 2005. The Order Ticket enhancement would allow floor brokers and their clerks to create electronic, time stamped, handwritten order tickets which would be saved by the Exchange as JPEG files.

A broker or clerk using the proposed BARS Order Ticket enhancement would select a new "Order Ticket" button on the booth or hand held BARS terminal, which would create a blank image template on a screen that exists on both the booth and hand held BARS terminals. Brokers and their clerks would write on the screen with a stylus and record order terms just as if they were using a paper order ticket. A person using the Order Ticket enhancement would be required to record the following order terms on the ticket prior to representing the order in the trading crowd:

- Buy/Sell
- Symbol
- Quantity
- Call/Put (calls would be assumed unless "P" is written)
- Expiration
- Strike (fractions would be assumed, e.g., "22½" would be written as "22")
- Price term (a limit order would be assumed if a price were written, e.g., "1.20" would mean a 1.20 limit. Market orders would be blank or represented by a dash)
- Contingencies (if applicable, e.g., NH, AON, FOK, IOC, stock)
- Open/Close (close would be assumed unless "O" is written)
- Customer/Firm/Member Market Maker/Non-Member Market Maker (customer would be assumed unless "F", "P" or "N" is written.)
- Give-up

At the first mark on the template, the Order Ticket would be automatically time stamped by the Exchange's systems to the nearest second. When the broker or clerk finishes entering the information on the Order Ticket, he or she would be required to hit a "save" button, and the Order Ticket would be assigned a specific sequence number. Once the "save" button is hit, the Order Ticket could not be modified and would be stored by the Exchange as a JPEG file.

Once the order is systematized in Order Ticket, the member or member organization that accepted the order would be required to transfer the order terms into BARS so that a record of the order may be maintained in the Exchange's AOF system and any trade information submitted to comparison. In order to enter the order into BARS, a floor broker or clerk would open a BARS OET on a saved Order Ticket by selecting a new OET button within the image. This would cause both the time stamp and the sequence number from the Order Ticket to be automatically transferred from the Order Ticket to the OET. The transfer of the time stamp and sequence number would be done by the Exchange's systems and could not be modified by the broker or clerk. The broker or clerk then would be required to enter the required order terms into the OET and transmit the order to AOF. The broker or clerk also would be required to enter any information pertaining to a modification or cancellation of an order, or the execution of an order, directly into BARS from where it would be transmitted to AOF. Information pertaining to order modifications and cancellations would be required to be systematized prior to representation of the revised order in the crowd.

The Exchange further proposes that any proprietary system approved by the Exchange on the Exchange's trading floor which receives orders would be considered an Exchange system for the purpose of systematizing those options orders and modifications and cancellations of such orders that are not already systematized in an Amex system prior to representing the orders in the

crowd. Any proprietary system approved by the Exchange would be required to have the functionality to comply with the requirements of COATS.

Under the proposed rule change, orders for FLEX options and accommodation trades would not have to be systematized prior to representation. Information about these orders would be required to be submitted to the Exchange on trade date no later than 10 minutes after the close of trading. The Exchange would maintain information submitted to it pertaining to FLEX options and accommodation trades in the COATS format.

#### **IV. Discussion**

After careful consideration, the Commission finds that the proposed rule change is consistent with Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>7</sup> In particular the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>8</sup> which requires among other things, that the Exchange's rules be designed to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest.

The Commission believes that the rules as proposed should allow the Exchange to comply with its obligations under the Order in that they will result in the creation of an audit trail that incorporates manual orders sent to Amex. Specifically, the proposed rule change requires that Amex members enter certain order details immediately upon receipt, prior to representation of the order, into BARS or in the Order Ticket enhancement to BARS for later integration into

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<sup>7</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

COATS, which the Commission believes should result in an accurate, time-sequenced record of orders.

The Commission notes that the Exchange has acknowledged the need for effective and proactive surveillance for activities such as trading ahead and front-running in connection with the creation of its audit trail. The Exchange represents that it currently conducts automated surveillance for such activities and will incorporate a review of order systemization as part of such surveillance. The Exchange also states that it intends to implement supplementary surveillance and examination programs related to the systemization of orders requirement promptly after this requirement is instituted, which are designed to address, among other things, trading ahead and front-running. The Commission views effective surveillance as critical to the integrity of COATS and expects that the Exchange will inform the Commission of any problems it encounters in conducting effective surveillance.

The Commission finds good cause for accelerating approval of the proposed rule change and Amendment No. 1 thereto, prior to the thirtieth day after the date of the publication of notice thereof in the Federal Register. The Commission notes that the proposed rule change was noticed for a 15-day comment period and no comments were received. The Commission believes that it is appropriate to accelerate approval of the proposed rule change and Amendment No. 1 thereto so that the rule may be implemented on a timely basis to ensure prompt compliance with the undertakings contained in the Commission's Order.

## **V. Conclusion**

For all of the aforementioned reasons, 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.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (SR-Amex-2003-90) and Amendment No. 1 are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 17 CFR 200.30-3(a)(12).