

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60015; File No. SR-NYSEAmex-2009-19)

June 1, 2009

Self-Regulatory Organizations; NYSE Amex LLC; Notice of Filing of Proposed Rule Change to Adopt Rules to Implement the Options Order Protection and Locked/Crossed Market Plan

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 11, 2009, the NYSE Amex LLC (“NYSE 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 Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to adopt rules to implement the Options Order Protection and Locked/Crossed Market Plan. The text of the proposed rule change is available on the Exchange’s Web site at [www.nyse.com](http://www.nyse.com), at the Exchange’s principal office and at the Commission’s Public Reference Room.

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 self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the

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

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

places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

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

1. Purpose

The Exchange proposes to adopt rules to implement the Plan. These rules will replace Rules 990NY through 993NY of the Exchange’s rules in their entirety. The proposed rules also will amend or remove various other rules to accommodate the Plan.

Background to the Plan and the Implementing Rules

NYSE Amex filed the current version of the Plan on November 25, 2008.<sup>3</sup> The Plan would replace the current Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Old Plan”). The Old Plan requires its participant exchanges to operate a stand-alone system or “Linkage” for sending order-flow between exchanges to limit trade-throughs. The Options Clearing Corporation (“OCC”) operates the Linkage system. The Linkage rules provide for unique types of Linkage orders, with a complicated set of requirements as to who may send such orders and under what conditions.

While the Linkage largely has operated satisfactorily, it is under significant strain. When the Commission approved the Old Plan in 2000, average daily volume (“ADV”) in the options market was approximately 2.6 million contracts across all exchanges. Now the ADV has increased

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<sup>3</sup> The November 25, 2008 filing was Amendment No. 1 to the Plan. The American Stock Exchange LLC (the predecessor to NYSE Amex LLC) initially filed the Plan on June 17, 2008.

to more than 10 million contracts, putting added strain on the ability of market makers to comply with the complex Linkage rules. At the same time, the options markets have been moving towards quoting in pennies, and are quoting in pennies options representing over half the total industry volume. This greatly increases the number of price changes in an option, giving rise to greater chances of trade-throughs and missing markets as market makers send Linkage orders and have to wait for a response.

Experience in the equities markets shows that there is a more efficient way to provide price protection in options. When first implemented, the Linkage represented a vast improvement over the then-current equities price-protection system, which depended on the operation of the Intermarket Trading System (“ITS”). The plan governing ITS imposed long waiting times for filling ITS commitments and a cumbersome method for satisfying trade-throughs. Learning from the shortcomings of ITS, the options Linkage has shorter waiting periods and more efficient trade-through protections.

The equity price-protection mechanisms have now leapfrogged the options Linkage. By adopting Regulation NMS in 2005 the Commission effectively terminated ITS, replacing it with a rules-based price-protection system.<sup>4</sup> The key to Regulation NMS’s price-protection provisions is the Intermarket Sweep Order, or ISO. Each equity exchange must adopt rules “reasonably designed to prevent trade-throughs.”<sup>5</sup> Exempted from trade-through liability is an ISO, which is an order a member sends to an exchange displaying a price inferior to the national best bid and

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<sup>4</sup> Release No. 34-51808 (June 9, 2005), 70 F.R. 37496 (June 29 2005).

<sup>5</sup> Regulation NMS Rule 611(a).

offer (“NBBO”), while simultaneously sending orders to trade against the full size of any other exchange that is displaying the NBBO.<sup>6</sup>

The Regulation NMS rules-based price-protection system is working well. It requires neither a central linkage mechanism nor a complex set of operating rules. It also has eliminated the need for achieving unanimity to change even the most minor aspects of a linkage mechanism. A simple prohibition against most trade-throughs, coupled with the ISO mechanism, has given the equities markets a straight-forward system to provide customers with price protection in a fast-moving, high-volume market that is quoted in pennies. NYSE Amex and the other options exchange participants in the Plan intend for the Plan, and the implementing rules, to bring the efficiencies of Regulation NMS to the options market.

#### Operation of the Plan

The Plan effectively would apply the Regulation NMS price-protection provisions to the options markets. Similar to Regulation NMS, the Plan would require participants to adopt rules “reasonably designed to prevent Trade-Throughs,” while exempting ISOs from that prohibition.<sup>7</sup> The definition of an ISO is essentially the same as under Regulation NMS,<sup>8</sup> and there are a number of additional exceptions to the trade-through prohibition. Like Regulation NMS,<sup>9</sup> the Plan requires participating exchanges to take reasonable steps to establish that ISOs meet the requirements of the Plan.

With respect to locked and crossed markets, similar to Regulation NMS the Plan requires its participants to adopt, maintain and enforce rules requiring members: to avoid displaying

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<sup>6</sup> Regulation NMS Rule 600(b)(30).

<sup>7</sup> Sections 5(a)(i) and 5(b)(iv) of the Plan.

<sup>8</sup> Section 2(9) of the Plan.

<sup>9</sup> Regulation NMS Rule 611(c) and Section 5(c) of the Plan.

locked and crossed markets; to reconcile such markets; and to prohibit members from engaging in a pattern or practice of displaying locked and crossed markets.<sup>10</sup> With respect to locked markets, the Plan differs from Regulation NMS in that it specifically permits exceptions to the locked market prohibitions “as contained in the rules of a Participant approved by the Commission.”<sup>11</sup>

#### Description of the Implementing Rules

The Exchange proposes to define “Intermarket Sweep Order” as a new order type in proposed Rule 900.3NY(t).

Other proposed rule changes would amend and replace NYSE Amex’s current Linkage rules in Rules 940 and 990NY – 993NY as described below:

#### Rule 990NY – Definitions

This proposed rule incorporates all the operative definitions from the Plan into the NYSE Amex rulebook. With one exception, the parties to the Plan derived all such definitions either from the Old Plan<sup>12</sup> or Regulation NMS.<sup>13</sup> The one exception is the definition of “complex trade” in Rule 990NY(4). A “complex trade” is exempt from trade-through liability. The exemption in the Old Plan simply refers to complex trades “as that term may be defined by the Operating Committee from time to time.” Based on that provision, the Exchange had previously adopted

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<sup>10</sup> Section 6 of the Plan.

<sup>11</sup> Id.

<sup>12</sup> See, e.g., the definitions of “Broker-Dealer” in Rule 990NY(3), NBBO in Rule 990NY(10), Non-Firm in Rule 990NY(11), OPRA Plan in Rule 990NY(12), and Participant in Rule 990NY(13).

<sup>13</sup> See, e.g., the definitions of “Best Bid”/“Best Offer” in Rule 990NY(1), “Bid”/“Offer” in Rule 990NY(2), “Intermarket Sweep Order (“ISO”)” in Rule 900.3NY(t), and “Quotation” in Rule 990NY(16).

current Rule 940(b)(3), which is substantially identical among all the options exchanges. We propose to carry that definition into the revised Rule 990NY unchanged.

#### Rule 991NY – Order Protection

Paragraph (a) of Rule 991NY provides that, subject to specified exceptions, NYSE Amex ATP Holders shall not effect trade-throughs. Paragraph (b) provides for the following trade-through exceptions:

- System Issues: Rule 991NY(b)(1) implements Section 5(b)(i) of the Plan by establishing an exception for trade-throughs due to system-failures. This is akin to the exception in Regulation NMS for equity securities and permits trading through an Eligible Exchange that is experiencing system problems.<sup>14</sup> The Exchange is proposing “self-help” rules similar to its NYSE Amex Equities Rule 126A-AEMI, adopted pursuant to Regulation NMS.
- Trading Rotations: Rule 991NY(b)(2) implements Section 5(b)(ii) of the Plan and carries forward the current trade-through exception in the Old Plan<sup>15</sup> and current Rule 991NY (b)(5) related to the opening of markets. It is the options equivalent to the single price opening exception in Regulation NMS for equity securities.<sup>16</sup> NYSE Amex uses a trading auction to open an option for trading, or to reopen an option after a trading halt. The opening is effectively a single price auction to price the option and there are no practical means to include prices on other exchanges in that auction.

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<sup>14</sup> See Regulation NMS Rule 611(b)(1).

<sup>15</sup> See Old Plan Section 8(c)(iii)(E).

<sup>16</sup> See Regulation NMS Rule 611(b)(3) under the Securities Exchange Act of 1934, as amended (“Exchange Act”).

- Crossed Markets: Rule 991NY (b)(3) implements Section 5(b)(iii) of the Plan and is the functional equivalent to NYSE Alternext Equities Rule 128C-AEMI for equity securities. If the best intermarket bid is higher than the best intermarket offer, it indicates that there is some form of market dislocation or inaccurate quoting. Permitting transactions to be executed without regard to trade-throughs in a Crossed Market will allow the market quickly return to equilibrium.
- Intermarket Sweep Orders (“ISOs”): Rule 991NY (b)(4) is the ISO exemption and implements Sections 5(b)(iv) and (v) of the Plan. Section 5(b)(iv) of the Plan permits a Participant to execute orders it receives from other Participants or members that are marked as ISO even when it is not at the NBBO. Section 5(b)(v) of the Plan allows a Participant to execute inbound orders when it is not at the NBBO, provided it simultaneously “sweeps” all better-priced interest displayed by Eligible Exchanges. These provisions are the options equivalents of the corresponding Regulation NMS equity rules.<sup>17</sup>
- Quote Flickering: Rule 991NY (b)(5) implements Section 5(b)(vi) of the Plan and corresponds to the flickering quote exception in Regulation NMS for equity securities.<sup>18</sup> Options quotations change as rapidly, if not more rapidly, than equity quotations. Indeed, they track the price of the underlying security and thus change when the price of the underlying security changes. This exception provides a form of “safe harbor” to market participants to allow them to trade through prices that have changed within a second of the transaction causing a nominal trade-through.

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<sup>17</sup> See Regulation NMS Rules 611(b)(5) and (6).

<sup>18</sup> See Regulation NMS Rule 611(b)(8).

- Non-Firm Quotes: Rule 991NY (b)(6) implements Section 5(b)(vii) of the Plan and carries forward the current non-firm quote trade-through exception in the Old Plan.<sup>19</sup> By definition, an exchange’s quotations may not be firm for automatic execution during this trading state and thus should not be protected from trade-throughs. In effect, these quotations are akin to “manual quotations” under Regulation NMS.
- Complex Trades: Rule 991NY (b)(7) implements Section 5(b)(viii) of the Plan and carries forward the current complex trade exception in the Old Plan.<sup>20</sup> Complex trades consist of multiple transactions (“legs”) effected at a net price, and it is not practical to price each leg at a price that does not constitute a trade-through.
- Customer Stopped Orders: Rule 991NY (b)(8) implements Section 5(b)(ix) of the Plan and corresponds to the customer stopped order exception in Regulation NMS for equity securities.<sup>21</sup> It permits broker-dealers to execute large orders over time at a price agreed upon by a customer, even though the price of the option may change before the order is executed in its entirety.
- Stopped Orders and Price Improvement: Rule 991NY (b)(9) implements Section 5(b)(x) of the Plan and would apply if an order is stopped at price that did not constitute a trade-through at the time of the stop. This exception applies to those exchanges that offer a “Price Improvement Mechanism” by which members could seek price improvement for that order, even if the market moves in the interim, and

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<sup>19</sup> See Old Plan Section 8(c)(iii)(C).

<sup>20</sup> See Old Plan Section 8(c)(iii)(G).

<sup>21</sup> See Regulation NMS Rule 611(b)(9).

the transaction ultimately is effected at a price that would trade through the then currently-displayed market.<sup>22</sup> NYSE Amex does not currently permit these types of options trades, and any transaction-type relying on this exemption would require the Exchange to adopt implementing rules, subject to Commission review and approval.

- Benchmark Trades: Rule 991NY (b)(10) implements Section 5(b)(xi) of the Plan and would cover trades executed at a price not tied to the price of an option at the time of execution, and for which the material terms were not reasonably determinable at the time of the commitment to make the trade. An example would be a volume-weighted average price trade, or “VWAP.” This corresponds to a trade-through exemption in Regulation NMS for equity trades.<sup>23</sup> NYSE Amex does not currently permit these types of options trades, and any transaction-type relying on this exemption would require the Exchange to adopt implementing rules, subject to Commission review and approval.

#### Rule 992NY – Locked and Crossed Markets

Proposed Rule 992NY implements Section 6 of the Plan, which requires Plan participants to establish, maintain and enforce rules that: require their members reasonably to avoid displaying locked and crossed markets; are reasonably designed to assure reconciliation of locked and crossed markets; and prohibit their members from engaging in a pattern or practice of displaying locked and crossed markets. Section 6 of the Plan further allows an exchange to provide exceptions to these limitations as “contained in the rules of a Participant approved by the Commission.”

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<sup>22</sup> See, for instance, ISE Rule 723.

<sup>23</sup> See Regulation NMS Rule 611(b)(7).

Proposed Rule 992NY(a) contains the general prohibition that NYSE Amex ATP Holders shall reasonably avoid displaying, and shall not engage in a pattern or practice of displaying, any quotations that lock or cross the best bid or offer of another exchange. We propose four exceptions to this general prohibition.<sup>24</sup>

The first exception would apply when we are experiencing system issues, and is similar to the systems issues exception to the trade-through rule. The second exception applies when there is a crossed market, and also is similar to the corresponding trade-through exception. The third exception would apply when an ATP Holder has simultaneously routed an ISO to execute against the full displayed size of any locked or crossed Protected Bid or Protected Offer. The fourth proposed exception applies to locked markets in the following circumstances:<sup>25</sup>

- Neither the locking or locked quote represents, in whole or in part, a customer order; or
- A customer enters a bid or offer that locks a non-customer quotation on another market, and the customer, on a case-by-case basis, authorizes the locking of the other market's quotation.

This fourth<sup>26</sup> exemption recognizes an important distinction between the equities and options markets. Options market makers compete for order flow by disseminating quotations in multiple series with respect to each underlying security, distributing liquidity over a much greater universe of products than in the equity markets. As a result, the options markets are more

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<sup>24</sup> See email from Andrew Stevens, Chief Counsel – U.S. Equities & Derivatives, NYSE Euronext, to David Liu, Assistant Director, Division of Trading and Markets, Commission, dated May 29, 2009.

<sup>25</sup> See id.

<sup>26</sup> See id.

reliant on market maker quotations to provide liquidity, with fewer customer orders in each series than in each underlying security, where liquidity is concentrated in one product.

With market makers on multiple exchanges constantly updating their quotations in all these series based on mathematical formulae there is a greater likelihood of market maker quotations locking. We believe that in most cases locked market maker quotations are good for the investing public. Effectively locked markets provide a “zero spread,” allowing market participants to buy and sell an option at the same price. On NYSE Amex these quotations are firm, and are fully executable on an automated basis.

We recognize that locked markets are more complicated where one or both of the locking quotations represents a customer order. Where there is contra-side market interest willing to trade with a customer, the customer order should be filled. Thus, we would not exempt from the locked market prohibition situations involving customer orders unless the customer entering the locking order specifically authorizes the lock on a case-by-case basis.<sup>27</sup>

The Exchange will not implement this proposed exception to the locked market prohibition unless the Exchange can identify that an order on another exchange is for the account of a customer. The options exchanges currently are working on a method to so identify customer quotations through the Options Price Reporting Authority. Absent the ability to identify a customer quote as part of an exchange’s BBO, NYSE Amex will assume that the quote represents, in whole or in part, a customer order. That is, NYSE Amex will not permit its members to avail themselves of this exemption unless another exchange has informed the Exchange that it will designate all customer orders as such at OPRA, and such exchange’s

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<sup>27</sup> We can envision a customer authorizing a lock when the fees associating with trading against the locked market make the execution price uneconomical to the customer.

quotation does not contain such designation. If an exchange opts not to identify its customer quotations, the Exchange will treat all of that exchange's quotations as customer orders and, absent application of another exception, will not permit locks of such quotations.

The Exchange also proposes that the exemption is only operative for as long as the Exchange is willing to identify Customer orders in its own quote.

#### Temporary Rule 993NY – Temporary Rule Governing P and P/A Orders

When the Plan and implementing rules become operative it is possible that not all the options exchanges will be functionally able to operate pursuant to the Plan. Thus, in order to ensure there is full intermarket trade-through protection during this interim period, we propose to retain certain minimum trade-through rules based on the Old Plan until all the options exchanges are operating pursuant to the Plan. When that occurs we will file a rule change with the Commission to delete Temporary Rule 993NY.

Temporary Rule 993NY provides that NYSE Amex will continue to accept Principal Acting as Agent (“P/A”) and Principal Orders from options exchanges which have not fully discontinued use of the OCC managed routing hub. The handling of these orders will be subject to Temporary Rule 993NY.

#### Amendment of other NYSE Amex Rules to Accommodate the Plan

We propose to amend four NYSE Amex rules in addition to those described above. First, Rule 921NY, Registration of Market Makers, allows certain Market Makers to act in an agency capacity for the purpose of sending Principal Acting as Agent (“P/A”) Orders through the Linkage. With the termination of the Linkage such provision no longer will be necessary and we thus propose to delete this provision.

Second, Rule 923NY, Appointment of Market Makers, Commentaries .01 - .03 describes Intermarket Linkage Market Makers (“IMM”) and described when and how IMMs would be appointed, and the procedures that governed their appointment with the termination of the Linkage such provisions will no longer be necessary and we thus propose to delete them.

Rule 964NY, Display, Priority and Order Allocation – Trading Systems, will be amended to remove references to the Intermarket Linkage.

Finally, Rule 476A, Minor Rule Plan, describes certain violations which are part of an expedited disciplinary process, and their attendant fines. The exchange proposes to modify those violations which are related to the Linkage and make them applicable to the Plan and the proposed Rules.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the “Act”).<sup>28</sup> The basis under the Act for this proposed rule change is found in Section 6(b)(5) of the Act,<sup>29</sup> in that the proposed rule change is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest. In particular, the Exchange believes that adopting rules that implement the Plan will facilitate the trading of options in a national market system by establishing more efficient protection against trade-throughs and locked and crossed markets.

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<sup>28</sup> 15 U.S.C. 78f(b).

<sup>29</sup> 15 U.S.C. 78f(b)(5).

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

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

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

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 Exchange consents, the Commission will:

- (A) by order approve the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change 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 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 No. SR-NYSEAmex-2009-19 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEAmex-2009-19. 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, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying

information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSEAmex-2009-19 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>30</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>30</sup> 17 CFR 200.30-3(a)(12).