

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-Amex-2007-127 and should be submitted on or before December 27, 2007.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56868; File No. SR-Amex-2007-125]

### Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Establish a Riskless Principal and Other Exceptions to Amex Rules Prohibiting Members' Proprietary Trading While in Possession of Like or Better-Priced Customer Orders

November 29, 2007.

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 November 16, 2007, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared substantially by the Amex. The Amex has submitted the proposed rule change under section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. 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 Amex proposes to adopt changes to Rules 24—AEMI, "Limitations on Members' Trading Because of

Customers' Orders," 151—AEMI, "Purchases and Sales While Holding Unexecuted Market Order," and 152—AEMI, "Taking or Supplying Stock to Fill Customer's Order," to: (i) provide for a "riskless principal" and other exceptions to the Amex's general rules against members entering proprietary orders while in possession of a customer order that could trade at the same price; and (ii) make various "housekeeping" changes to eliminate duplicative or unnecessary portions of the AEMI rules.

The text of the proposed rule change is available at <http://www.amex.com>, the principal offices of the Amex, and 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 Amex 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 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

To provide greater flexibility in trading methods available on the Amex, while still sufficiently protecting customer orders, the Amex proposes to adopt a "riskless principal" and other exceptions detailed below to its general rules against a member entering a proprietary order while in possession of a customer order that could trade at the same price. These new exceptions, which are the same as those adopted by the New York Stock Exchange LLC ("NYSE") in July 2007,<sup>5</sup> will be added to Rule 24—AEMI (which is the Amex equivalent of NYSE Rule 92, "Limitations on Members' Trading Because of Customers' Orders") and will promote regulatory consistency. Additionally, the Amex proposes to make certain housekeeping changes occasioned by the changes to Rule 24—AEMI. Among other things, the Amex

proposes to: (i) Eliminate Rule 150—AEMI, which substantially overlaps with and is being folded into Rule 24—AEMI; and (ii) add a riskless principal exception to the general restrictions in Rule 152—AEMI against a member supplying/taking stock to fill a customer's order.

#### Riskless Principal Exception and Other Changes to Rule 24—AEMI

Rule 24—AEMI is substantially and structurally similar to the version of NYSE Rule 92 that existed until the NYSE amended its rule in July 2007.<sup>6</sup> In relevant part, the Amex intends to adopt the substance of those NYSE amendments to:

- Add a "riskless principal" exception that would allow a member to trade a security as principal while holding one or more customer orders in the security to permit the member to pass on to its customer(s) the prices received on the Exchange;<sup>7</sup>
- Amend certain customer consent requirements to allow a customer to give affirmative prior blanket—rather than order-by-order—consent to a member trading while in possession of a customer order, as permitted by the rule, provided that the requisite disclosures to the customer regarding potential trading-along, opt-out rights, and allocation methodology are periodically made<sup>8</sup> and such informed

<sup>6</sup> See note 5, *supra*.

<sup>7</sup> A member would be permitted to aggregate only those customer orders where the order types and instructions (including tick restrictions) permit such aggregation. Such aggregating meets the standards set forth in the July 18, 2005, no-action letter from the Division of Trading and Markets ("Division") (f/k/a the Division of Market Regulation) to the Securities Industry Association ("SIA"), in which the Division granted a riskless principal exemption from Rule 10a-1 under the Act to permit a broker-dealer to fill a customer order without complying with the "tick" provisions of Rule 10a-1, in certain situations and subject to certain conditions. See letter from James Brigagliano, Assistant Director, Division, Commission, to Ira Hammerman, Senior Vice President and General Counsel, SIA, dated July 18, 2005.

<sup>8</sup> The required periodic disclosures would include affirmative notice of: (i) the fact that the member may trade along with the customer's order, subject to the customer's right to affirmatively opt-out of such trading-along on an order-by-order basis or to modify the instructions obtained under the blanket consent; and (ii) the method by which the member organization will allocate shares to the customer's order (including the allocation methodology for riskless principal transactions that include Rule 24—AEMI(b) proprietary orders and orders from customers that have and/or have not consented to trade along with such proprietary orders). The Exchange would not require a specific allocation methodology (e.g., strict time priority, precedence based on size, etc.), but would require it to be fair and reasonable, consistently applied, consistent with the rules governing parity of orders, and not unfairly discriminatory against any particular class of accounts or types of orders.

<sup>15</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> See Securities Exchange Act Release Nos. 56017 (July 5, 2007), 72 FR 38110 (July 12, 2007) (order approving File No. SR-NYSE-2007-21); and 56088 (July 18, 2007), 72 FR 40351 (July 24, 2007) (notice of filing and immediate effectiveness of File No. SR-NYSE-2007-63).

customer consent has been documented;<sup>9</sup>

- Expand the class of customers eligible to give affirmative consent from institutional investors with 10,000-share orders or more to all institutional investors and individual investors with orders of 10,000 shares (worth at least \$100,000) or more; and

- Add an exception which would permit specialists to trade proprietarily ahead of held customer orders 2½ hours after the close of regular trading and up to 15 minutes prior to the following trading day's opening, thereby better allowing the specialists to hedge their trading risk and bring their dealer accounts in line with trading in away markets.

According to the Amex, these changes will serve to harmonize Rule 24—AEMI with the guidelines of the Financial Industry Regulatory Authority, Inc. ("FINRA," f/k/a NASD) on members trading while in possession of customer orders, commonly known as the "Manning Rule,"<sup>10</sup> so as to provide a more consistent regulatory environment for broker-dealers. The Amex intends to make the same amendments in substance to its Rule 24—AEMI as the NYSE made to its Rule 92, with slight differences discussed below.

New NYSE Rule 92(c)(3) requires, among other things, that in order to avail itself of the riskless principal transaction:

A member must submit a report of execution of the facilitated order to a designated Exchange database as required by NYSE Rule 123(f). The member must also submit to the same database, within such time frame and in such format as the Exchange may from time to time require, an electronic report containing data elements sufficient to provide an electronic link of the execution of the facilitated order to all of the underlying orders.

The referenced "Exchange database" is the NYSE's Front End Systemic Capture ("FESC") database. The Amex does not have a database that is able to capture order and execution data with respect to riskless principal transactions in the same manner as FESC.

<sup>9</sup> Acceptable documentation of customer consent following delivery of the required disclosures would be: (i) A signed writing from the customer that acknowledges receipt of the required disclosures and provides consent; or (ii) in the case of oral customer consent, by a written notice from the member sent to the customer documenting the provision of such required disclosures and such oral consent. Once a customer has provided affirmative consent and so long the firm continues to provide written disclosures on a periodic basis, the firm will not need to renew such affirmative consent.

<sup>10</sup> See FINRA IM 2110-2 and FINRA Rule 2111.

Accordingly, the Amex's regulatory staff will need to surveil for proper use of the new riskless principal exemption simultaneous with general surveillance of transactions where members trade ahead of customers orders under pre-existing exceptions to Rule 24—AEMI. Should a transaction appear to be a riskless principal transaction, Amex Regulation will validate that all elements required by the exception are met by requesting and reviewing supporting documentation from the members involved, rather than automatically surveilling for violations as the NYSE is presumably able to do with its FESC system. Accordingly, because technological differences require the development of a slightly different audit trail, Amex's corresponding paragraph in Rule 24—AEMI will state:

A member or member organization must maintain a contemporaneous record of every execution on a riskless principal basis, which record shall be submitted to the Exchange within such time frame, in such format, and containing such information (in addition to any information required by Rule 153—AEMI) as the Exchange may from time to time require to validate the riskless principal nature of the transaction.

Other wording, structural, or grammatical differences between comparable sections of NYSE Rule 92 and Rule 24—AEMI are not intended to create substantive differences and are intended only to add clarity where the Amex thought necessary for its members.<sup>11</sup>

<sup>11</sup> For example, while the NYSE chose to make the riskless principal exception a separate subsection (c) to its Rule 92 (with the remaining exceptions listed in NYSE Rule 92(d)), Amex preferred to list all exceptions—including the riskless principal transaction exception—in the same subsection of its equivalent Rule 24—AEMI(c). For another example, NYSE Rule 92(b) begins:

A member or member organization may enter a proprietary order while representing a customer order that could be executed at the same price, provided that the customer's order is designated not held and is for (i) an institutional account, or (ii) over 10,000 shares, unless such orders are less than \$100,000 in value, and the member organization periodically provides written disclosures to its customers and obtains and documents affirmative customer consent, under the following conditions.

Comparable Rule 24—AEMI(b), as proposed to be amended, provides:

A member or member organization may enter a proprietary order while representing a customer order which could be executed at the same price, provided:

(1) The customer's order is designated not held and is (i) an institutional account, or (ii) over 10,000 shares (unless such orders are less than \$100,000 in value); and the member organization has periodically provided written disclosures to such customer of the possibility and allocation

## Housekeeping Changes

Existing Rule 24—AEMI substantially overlaps with existing Rule 150—AEMI, in that both rules recite the general prohibitions upon, and exceptions to, an Amex member trading a proprietary order while in possession of a customer order that could be executed at the same price. To eliminate future confusion, the Amex proposes to eliminate Rule 150—AEMI (which is a vestige of pre-AEMI Amex Rule 150) in favor of merging the two rules into Rule 24—AEMI (which was originally patterned after NYSE Rule 92). This will result in three exceptions being added to Rule 24—AEMI, but no substantive expansion of the list of exceptions available pre-amendment (except as noted above by expanding the exceptions to include the recent changes made to comparable NYSE Rule 92).<sup>12</sup>

Additionally, Commentary .06 to Rule 24—AEMI will now clarify that the riskless principal exception of new subsection (c)(10) applies only to orders entered from off the floor of the Exchange, and that specialists, in particular, remain bound by Rule 155—AEMI, "Precedence Accorded to Orders Entrusted to Specialists," which contains no such exception (replacing existing Commentary .06, which deals with the interplay between the now-defunct Intermarket Trading System Plan and Rule 24—AEMI).

Finally, Rule 152—AEMI (originally patterned after NYSE Rule 91), which currently contains the general prohibitions upon, and exceptions to, supplying/taking stock to fill a customer's order, will be amended to incorporate the new riskless principal transaction exception, as such transactions, by definition, include a member supplying/taking stock to fill a customer's order.<sup>13</sup>

methodology of its potential trading along and obtained and documented such customer's affirmative consent to same; and

(2) one of the following conditions exists. \* \* \*

<sup>12</sup> Note, however, that the former Rule 150—AEMI(c)(5) exception for a purchase or sale of an exchange-traded fund by a specialist where the specialist is on parity with another broker-dealer order pursuant to the Exchange's rules (e.g., Rule 126—AEMI) has been incorporated in new Rule 24—AEMI(c)(7) as "any purchase or sale of any security \* \* \* by a specialist whose bid (offer) is on parity with a customer's order pursuant to Rule 126—AEMI." The new phrasing more accurately describes the operation and application of Rule 126—AEMI, under which a specialist has been and is permitted to trade on parity with a customer under a variety of circumstances broader than reflected in former Rule 150—AEMI(c)(5).

<sup>13</sup> The Amex notes that the NYSE did not so amend its comparable NYSE Rule 91, although it is not clear why.

## 2. Statutory Basis

The proposed rule change is designed to be consistent with Regulation NMS,<sup>14</sup> as well as section 6(b) of the Act,<sup>15</sup> in general, and furthers the objectives of section 6(b)(5) of the Act,<sup>16</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 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.

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

The Amex believes that the proposed rule change does not 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 formal written comments were solicited or received with respect to the proposed rule change itself, but Amex staff have had numerous communications with representatives of the Securities Industry and Financial Markets Association, which have requested that the Amex amend its rules to match the recent changes to NYSE Rules 92, as described above.

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

The Amex has designated the proposed rule change as one that: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. In addition, as required under Rule 19b-4(f)(6)(iii),<sup>17</sup> the Amex provided the Commission with written notice of its intention to file the proposed rule change, along with a brief description of the text of the proposed rule change, at least five business days prior to filing the proposal with the Commission. Therefore, the proposed rule change has become effective pursuant to section 19(b)(3)(A) of the

Act<sup>18</sup> and Rule 19b-4(f)(6) thereunder.<sup>19</sup>

The Amex has requested the Commission to waive the 30-day operative delay because of the commencement of full industry compliance with Rules 610 and 611 of Regulation NMS<sup>20</sup> and the broker-dealer community's desire to have the riskless principal exception in place at all automated market centers as soon as possible. In addition, the Amex states that the proposed changes are similar to those adopted by the NYSE and do not raise new issues.

The Commission hereby grants the Amex's request<sup>21</sup> and believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because the changes to Rule 24—AEMI are substantially similar to changes adopted previously by the NYSE.<sup>22</sup> The remaining changes to Rules 24—AEMI and 152—AEMI, and the elimination of Rule 150—AEMI, are designed to streamline and clarify the Amex's rules and do not raise new regulatory issues. For these reasons, the Commission designates that the proposed rule change become operative immediately.

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.

## 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 Number SR-Amex-2007-125 on the subject line.

<sup>18</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>19</sup> 17 CFR 240.19b-4(f)(6).

<sup>20</sup> 17 CFR 242.610 and 17 CFR 242.611.

<sup>21</sup> For purposes of waiving the 30-day operative delay, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>22</sup> See note 5, *supra*.

## Paper Comments

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

All submissions should refer to File Number SR-Amex-2007-125. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. 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 publicly available. All submissions should refer to File Number SR-Amex-2007-125 and should be submitted on or before December 27, 2007.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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<sup>14</sup> 17 CFR 242.600 *et. seq.*

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

<sup>16</sup> 15 U.S.C. 78f(b)(5).

<sup>17</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>23</sup> 17 CFR 200.30-3(a)(12).