SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41527; File No. SR–Amex–99–08]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the American Stock Exchange LLC Relating to the Development of a New Equity Market Structure

June 15, 1999.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'' or ''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on February 16, 1999, the American Stock Exchange LLC (''Amex'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commisson'' or ''SEC'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. Amex filed an amendment to the proposed rule change on May 24, 1999.[3] 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 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 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 these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from William Floyd-Jones, Assistant General Counsel, Legal and Regulatory Policy, Amex, to Michael Walinskas, Associate Director, Division of Market Regulation, Commission, dated May 21, 1999 (''Amendment No. 1''). Amendment No. 1 replaces and supersedes the original filing.

A. Self-Regulatory Organizations' Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Introduction

The Exchange intends to implement a program to change and make its equity market operation more competitive (the ''New Equity Market Structure''). A key element of the program is the development of a new electronic order book for equities incorporating automatic execution for electronically delivered orders and transparency of the book up to two minimum trading increments (''ticks'') away from the Amex bid and offer. In order to integrate traditional auction market processes with automatic execution of electronically delivered orders, the Exchange will amend it rules to specify that bids and offers in the trading crown must be incorporated in the Amex published quote to be eligible to interact with marketable electronic orders, and that a bid or offer in the quote is not deemed to be accepted by a member on the floor until the specialist enters the acceptance into the book.

To reduce the cost of doing business on the Amex, the Exchange intends to prohibit specialists from charging a commission for executing orders delivered electronically from off the floor for securities traded under the New Equity Market Structure. The Amex will waive a portion of its fees imposed on specialists and will share its revenue with specialists to effectively offset the specialists' loss of floors brokerage with respect to orders delivered electronically from off the floor for securities traded under the New Equity Market Structure. In addition, the Exchange proposes to eliminate the stabilization requirements of Commentaries, .01, .02, and .07 to Rule 170 and expand the parameters of the ''2, 1, ½ point Rule'' (Rule 154, Commentary .08) to permit specialists to respond to the needs of the fast moving, modern market without unnecessary restrictions.

New Electronic Order Book for Equities

Look at the Book

Specialists will continue to see the entire limit order book at they currently do. In addition, the Exchange will provide trading crowds, booths on the trading floor, and upstairs members with information regarding limit orders on the book up to two ticks away from the Amex displayed quote. Thus, limit order book information for a security that trades in minimum increments of 1/16 will be available for up to 12.5 cents away from the Amex best bid and offer. While limit order book information currently is available to floor brokers on an inquiry basis,[4] the proposed look at the book will make this information available systematically.

For example, assume the Amex quoted market for a stock is 20 to 20⅛, 5,000 by 5,000, and there are limit orders on the book to buy 2,000 shares at 19 5/16, buy 1,000 at 19⅞ and buy 1,000 at 19 13/16. In this example, the look at the book would include the orders to buy 2,000 by 19 15/16 and 1,000 at 19⅞. No limit order information would be disseminated if the order on the book closest to the Amex bid were the order to buy 1,000 at 19 13/16. For any securities that trade in increments smaller than 1/16 under the New Equity Market Structure, the look at the book will remain at two ticks and will narrow in dollar terms.

The Exchange will not include all or none orders, the unelected or unconverted portion of percentage orders, orders for non-regular way settlement,[5] and stop orders in the look at the book display. The Exchange believes that it would be inappropriate to disseminate information regarding all or none orders due to the restriction placed on the execution of these orders, and notes that these orders currently are not included in the Amex published quote.[6] Percentage orders require either an electing transaction or conversion by the specialist into a bid or offer to become capable to execution. Percentage orders, consequently, only will be included in the book or displayed in look at the book information upon election or conversion.[7] Non-regular way delivery is a fundamentally different proposition from standard settlement.[8] To prevent confusion, therefore, limit orders for non-regular way settlement will not be commingled with orders for regular way delivery in look at the book information. The Exchange also believes that the distribution of information regarding the existence and location of stop orders should be minimized to reduce opportunities for trading abuses.[9]

[4] Amex Rule 174.

[5] Orders for delivery on a cash, next day, or seller's option basis are non-regular way orders.

[6] Amex Rule 131(c). *See also* Exchange Act Rule 11 Ac1–4(c0(7).

[7] Amex Rules 131(n) and 154, Commentary .15.

[8] Amex Rule 126(a).

[9] ''Gunning'' stop orders, for example, is a practice whereby persons with knowledge of the location of stop orders will engage in buying or selling designed to elect the stop orders and trigger additional buying or selling.

Transmission of Orders and Crowd Interest

Market and limit orders will be transmitted electronically to the book from off the floor via CMS (''Common Message Switch'') and from on the floor via BARS (''Booth Automated Routing System'').[10] Floor brokers and traders may also drop hard copy limit orders with the specialist or stand in the crowd and bid and offer as they do currently. Specialist unit personnel will be responsible for entering dropped orders and bids and offers from the trading crowd into the book or the Amex published quote.

Orders and modifications to orders (*e.g.,* cancellations) that are electronically transmitted to the post will be processed automatically. For example, limit orders transmitted to the post electronically will be automatically filed in the limited order book in appropriate price/time priority and limit orders that would affect the Amex published quote will be automatically incorporated into the Amex published quotes.

Automatic Execution

Market and marketable limit orders entered electronically may execute automatically (*i.e.,* without any human intervention) against the Amex published quote up to the display size, and such executions will be automatically reported to the Tape and to the member firms that initiated the orders. Following an automatic execution, the specialist will have the ability to manually determine the new Amex published quote to assure appropriate representation of book, crowd and specialist proprietary interest.[11] The Exchange believes that customers will favor an automatic execution since it will speed reports and provide customers with increased control over their orders. Persons that do not wish an automatic execution may have their orders entered with a request for a ''stop'' and these orders will be ineligible for automatic execution.[12]

Crowd interest, the specialist's proprietary quote, and orders dropped by brokers must be incorporated into the Amex published quote to take part in automatic executions. Similarly, crowd interest, the specialist's proprietary quote and dropped orders will be firm with respect to electronic orders until physically removed form the Amex published quote. The Exchange is amending Rules 123 (''Manner of Bidding and Offering'') to provide that bids and offers must be incorporated into the published quote to preserve their standing with respect to incoming electronic orders, and that such bids and offers remain firm with respect to electronic orders until physically removed from the Amex quote or until an execution takes place.[13] Trades between brokers and traders in the crowd will occur outside the book and will be reported to the Tape.

The following examples will illustrate how automatic execution will work. Assume an Amex published quote of 20 to 20⅛, 5,000 by 5,000. Assume further that the bid consists exclusively of one order on the book, and that an order to sell 3,000 shares at the market is sent electronically to the floor. In this case, 3,000 shares would trade automatically at 20, the trade would be reported to the Tape, and execution reports would be sent to both the buy and sell side member firms. Automatic execution will work similarly if the Amex published bid consists of both booked limit orders and the specialist's proprietary interest. Assume an Amex published quote of 20 to 20⅛, 5,000 by 5,000, with the bid consisting of a 2,000 share limit order and the specialist's bid for 3,000 shares. Assume that an order to sell 3,000 shares at the market is sent electronically to the book. In this example, 3,000 shares would trade automatically at 20, the trade would be reported to the Tape, the book would automatically allocate 2,000 shares to the limit order and 1,000 shares to the specialist,[14] and execution reports would be sent to the buy and sell side firms.

The process will change slightly if the Amex published quote includes crowd interest. As before, the book will automatically execute eligible incoming electronic orders. The specialist, however, will manually allocate the execution on the contra side of the electronic order in accordance with the Exchange's rules of precedence. For example, assume the market is quoted 20 to 20⅛, 5,000, and an order to sell 3,000 shares at the market is sent electronically to the floor. Also assume that the bid consists of (i) the specialist as principal bidding for 1,000 shares, (ii) a broker representing a customer order bidding for 1,000 shares, (iii) a limit order on the book to buy 3,000 shares, and (iv) the broker and book bids are on parity. In this case, 3,000 shares would trade automatically at 20, the selling firm would get a report at 20, and the 3,000 share trade would print automatically. The specialist, however, would allocate the fill on the buy side of the trade in accordance with the Exchange's current rules of precedence.[15] Thus, in the example above, the specialist would allocate 2,000 shares to the order on the book and 1,000 shares to the broker in the crowd. Following the allocation, the book would automatically generate execution reports to the buy side firms.

In the event that an incoming executable electronic order is equal to or larger than the displayed quote, the incoming order will automatically execute to the full extent of the displayed quote, the trade will print, the member firm entering the electronic order will receive a report for the amount that traded, the specialist will manually requote the market, and the unexecuted balance of the incoming electronic order will be handled in accordance with the Exchange's current auction market processes. For example, assume the market for a stock is 20 to 20⅛, 5,000 by 5,000, and there are limit orders on the book to buy 2,000 at 19 15/16, by 1,000 to 19⅞ and buy 1,000 at 19 13/16. Assume further that there is a broker in the crowd working a sell order and that an electronic order to sell 7,000 shares at the market arrives at the book. The book would automatically execute 5,000 shares at 20 (the electronic order would sell all 5,000 shares) and print the trade. The specialist then would execute the remaining 2,000 shares of the unexecuted electronic market order given the limit orders on the book, the crowd's expressed interest, and the specialist's interest and requote the market.

Automatic execution will be unavailable when the specialist is in the process of manually executing a trade. This will occur in connection with (i) openings and reopenings, (ii) trades between the crowd and the specialist or orders in the book, (iii) trades between the specialist and the book, (iv) block trades, (v) the execution of queued orders, and (vi) the pendency of

[10] BARS is currently under development.

[11] During the brief period between an automatic execution and the time the specialist updates the market, the ''old'' quote will be unavailable for trading because the specialist will be in the process of revising the Amex published quote.

[12] An agreement to ''stop'' stock at a specified price constitutes a guarantee by the member who grants the stop to execute the order at the stop price or better. *See* Amex Rule 109.

[13] Amex has indicated that bids and offers will also remain firm with respect to electronic orders until an execution takes place. Telephone call between Michael Ryan, Chief of Staff & Senior Legal Officer, Amex, and Michael Walinskas, Associate Director, Commission, on June 4, 1999. Disputes regarding bids and offers will be resolved by Floor Officials. *See* Amex Rules 22 and 126(h).

[14] Amex Rule 155 provides that a specialist shall give precedence to orders on the book.

[15] Amex Rules 111, Commentary .07; 126(e); and 155.

Intermarket Trading System (''ITS'') commitments.

The Exchange will preserve its existing procedures for opening and reopenings to ensure single price openings.[16] A single price opening involves a balancing of supply and demand to arrive at a single consensus price that cannot be achieved by an automatic execution against a displayed bid or offer.

The Exchange's rules currently provide that a trade occurs upon the acceptance of a bid or offer.[17] Due to the speed of automatic executions, however, these executions could preempt trades executed in the traditional manner if automatic execution were available during the processing of such trades. For example, assume a broker walks into a crowd, asks for a market, and is told to 20⅛, 5,000 by 5,000. Assume the broker says ''sell 5,000.'' Under the Exchange's current rules, a trade has occurred on the broker's acceptance of the bid. However, if automatic execution were available during the processing of the trade, it would be possible for an incoming electronic order to hit the bid and sell the stock ahead of the broker. For this reason, automatic execution will be unavailable while manually executed trades are being processed.

The Exchange, accordingly, is amending Rule 128 to provide that a trade does not occur between a broker in the crowd and the specialist or another member whose bid or offer is incorporated in the Amex published quote until the specialist begins to process the trade.[18]

Automatic execution will be unavailable following automatic executions to allow for the inclusion of specialist and crowd interest in the Amex published quote. Where there is no crowd interest in the Amex published quote, there are no messages in queue that may affect the quote, and [19] the bid or offer is not exhausted, automatic execution will be available after a fixed time interval (*e.g.,* 15 seconds), or immediately after the specialist manually updates the market.[20] In those circumstances where there is crowd interest in the published quote, there are messages in queue that may affect the quote, or the bid or offer is exhausted, automatic execution will be available immediately after the specialist manually updates the market. For example, assume the market is 20 to 20⅛, 5,000 by 5,000, there is no crowd interest in the quote, and an order to sell 3,000 shares at the market is automatically executed. If the specialist takes no action following this trade and there are no messages in queue that would affect the quote, after a fixed time interval (*e.g.,* 15 seconds), the Amex published quote would automatically become 20 to 20⅛, 2,000 by 5,000, and automatic execution would become available.

Incoming electronic orders and other messages that may affect the quote (*e.g.,* order cancellations) will queue during times when automatic execution is unavailable. The specialist will neither have access to, nor be advised of the existence of, queued messages until the termination of queuing. The book will automatically process order cancellations and modifications and away from the market limit orders immediately following termination of queuing without manual intervention. After the book automatically processes order cancellations and modifications and away from the market limit orders, the specialist will manually process queued marketable orders to ensure maximum possible order interaction. Automatic execution will resume once all messages in the queue are processed and a new market is disseminated.

The benefits of manually processing of queued marketable orders are illustrated by the following example. Assume the market is 20 to 20⅛, 5,000 by 5,000 and a broker walks into the crowd and sells 5,000 shares, eliminating the entire Amex published bid. Assume that a market order to buy 1,000 shares and a market order to sell 1,000 shares both are received electronically by the book while the specialist processes the 5,000 share trade, and that the specialist requotes the market 19 15/16 to 20 1/16, 2,000 by 2,000, following the execution of the 5,000 share trade. If automatic execution were available prior to the disposition of the orders in the queue, the two electronic market orders would execute sequentially at different prices. To prevent this, the specialist will execute queued orders manually to ensure maximum potential order interaction. In this example, the specialist would pair-off the two orders at 20, requote the market at 19 15/16 to 20 1/16, 2,000 by 2,000, and automatic execution would resume.

The Exchange anticipates that during heavy trading it may be desirable to suspend automatic execution in a particular stock without queuing incoming messages. Such action only will be taken with the approval of a Floor Official. In addition, it may be necessary to suspend automatic execution on a floor-wide basis without queuing incoming messages in the event of systems difficulties or unusual market conditions. Floor-wide suspension of automatic execution only will be authorized by a Senior Floor Official. If automatic execution is suspended, orders and messages will be processed by the specialist in the same manner as they currently are handled.

Interaction With Other Markets

The new equity book will not permit automatic executions in situations where an away market displays a higher bid or lower offer for 200 or more shares. In these situations, the specialist will have the option either to manually execute the income order at the better price or transmit it to the away market. For example, assume the Amex market is 20 to 20⅛, 5,000 by 5,000, and an away market is bidding 20 1/16 for 200 shares. Assume that the book receives an electronic order to sell 200 shares at the market. In this case, the book would not execute the electronic order automatically. Instead, the specialist either would execute the order at 20 1/16, or ship it to the away market via ITS. Once the incoming order is shipped through ITS as a commitment, it can neither be executed on the Amex nor canceled by the originating firm until it expires (one minute) or is canceled by the receiving market.

The implementation of the new book will not result in the way ITS commitments are handled, and incoming ITS commitments will not receive an automatic execution. Similarly, the Exchange proposes to adopt new Rule 431 that would prohibit members and member organizations from submitting orders for market makers in other markets for automatic execution in the Exchange's trading system unless such market affords a comparable level of service to Amex specialists. The Exchange believes it is appropriate to not provide the new automatic execution service to the market in Amex listed stocks that

[16] Amex Rules 108(a) and 154, Commentary .07.

[17] Amex Rule 128 (''Contract Made on Acceptance of Bid or Offer'').

[18] Amex has indicated that the point at which the specialist ''begins to process the trade'' means when the specialist has accepted the trade and is ready to report it. Telephone call between Michael Ryan, Chief of Staff & Senior Legal Officer, Amex, and Michael Walinskas, Associate Director, Commission, on June 4, 1999.

[19] Amex has clarified that the filing should state ''and the bid or offer is not exhausted,'' not ''or the bid or offer is not exhausted.'' Telephone call between Michael Ryan, Chief or Staff & Senior Legal Officer, Amex, and Michael Walinskas, Associate Director, Commission, on June 4, 1999.

[20] *Id.*

excludes Amex specialists from their comparable services.[21]

During the period when there are pending incoming or outgoing ITS commitments, the book will not permit automatic executions in order to prevent trade throughs and to provide that the market does not change during the pendency of the commitments. During these times, incoming orders and cancellations (but not additional ITS commitments) will queue. Incoming ITS commitments will not queue to allow specialists sufficient time to respond to them within their life.

Specialists will not see queued messages or receive an advice of their existence prior to processing except when an ITS commitment is received while messages already are in queue (*i.e.*, there is a preexisting queue at the time the commitment arrives). In this one circumstance, specialists will receive an advice that there are orders in queue without any specification as to the contents of the queued messages (*e.g.*, whether the messages are buy or sell orders or the size of the orders). This advice will permit specialists to process queued orders and ITS commitments together in their proper time sequence following the conclusion of the event that caused the initial suspension of automatic execution. Automatic execution will resume once the orders in the queue and the ITS commitment are processed.[22]

Market Surveillance

The Exchange currently requires specialists to maintain and file with the Exchange a paper record of their principal transactions in both specialty securities and related derivative securities. This record, referred to as the ''191 Book'' after the Exchange Rule that requires its preparation, is a three-part form that includes for each specialty security opening positions, principal trades, trade times, contra broker badge numbers, and tick. In addition, certain actions by specialists require Floor Official approval, and these approvals traditionally have been memorialized by the Floor Official signing the specialist's 191 Book.[23]

Today, the Exchange's regulatory staff go to the trading floor if they wish to see specialist trading information in real-time. The new equity book, however, will update this procedure and electronically provide the Exchange's regulatory personnel with specialist trading activity in real-time. The new book also will maintain a record of Floor Official approval of specialist transactions. The Exchange, accordingly, is amending Rule 191 to eliminate those specialist's record keeping requirements that will be captured and maintained by the Exchange's new systems.

Pilot and Roll-Out of the New Equity Book

The Exchange anticipates that it will implement the use of the new equity book on a pilot basis during the third quarter of 1999 and that providing the look at the book to upstairs members may require additional time. The initial pilot will involve a cross section of listed stocks and will last for approximately six months. In recognition of the fact that Index Share products (*e.g.*, Portfolio Depositary Receipts and Index Fund Shares) have trading characteristics, and in certain respects trade under rules, that differ from those applicable to other products traded under the Exchange's equity rules, the New Equity Market Structure and the associated rule changes are not intended to be applied to Index Share products.

The Exchange will use the new equity book for actual trading during the pilot phase, and may make changes to the book as the result of operational experience or to enhance the system. Following the completion of the pilot program and the implementation of any changes to the book, the Exchange will commence its floor wide introduction. This roll-out will be done in steps to accommodate training and technical considerations.

Floor Brokerage

Specialists will not be permitted to charge commissions upon the execution of orders delivered electronically from off the floor for securities traded under the New Equity Market Structure. This should reduce the cost of doing business on the Exchange and thereby benefit investors. Specialists will continue to be able to charge floor brokerage on manually delivered orders. The Exchange also is proposing to confirm that specialists may charge a commission on hand delivered orders when acting as principal if the member leaving the order consents. The Exchange proposes to amend Rule 152(c) in order to effect these changes.

The Amex will share its review with the specialists based on a specified rate schedule to effectively offset the specialists' loss of floor brokerage with respect to orders delivered electronically from off the floor of the Exchange. Index Share orders will not be covered by this program. Floor brokerage will cease and revenue sharing will commence for each equity security on the date such security begins trading under the New Equity Market Structure. In addition, any portion of the Amex regulatory fee payable by specialists on qualifying trades[24] that does not exceed $1.5 million in any year will be waived by the Amex.

Specialist Activity

The Exchange is proposing to eliminate the stabilization requirements of Commentaries .01, .02, and .07 to Rule 170 and expand the parameters of the ''2, 1, ½ point Rule'' (Rule 154, Commentary .08) to permit specialist to respond to the needs of the fast moving, modern market without unnecessary restrictions.

Specialists are subject to affirmative and negative obligations in trading for their account. The affirmative obligation requires them to engage in a course of dealing to assist in the maintenance, insofar as reasonably practical, of a fair and orderly market in specialty securities. This involves engaging in dealing reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, and to the minimizing of the effect of temporary disparities between supply and demand, immediate or reasonably anticipated. The negative obligation provides that specialists may not buy or sell a specialty security unless such dealings are reasonably necessary to permit specialist to maintain a fair and orderly market in such security.

Good specializing involves judgments as to the proper degree of continuity and the reasonableness of depth in light of shifting market conditions. The price of a stock, overall market trends, company specific news, order flow, the specialist's position in a stock and overall risk position, among other factors, go into the mix that needs to be considered in determining how

[21] Amex has clarified that the filing should state that a market, not a market maker, would be required to ''afford a comparable level of service.'' Telephone call between Michael Ryan, Chief of Staff & Senior Legal Officer, Amex, and Michael Walinskas, Associate Director, Commission, on June 4, 1999.

[22] The Amex specialist has no control over the execution or non-execution of outgoing commitments which may be canceled or expire in the receiving ITS market. Specialists, accordingly, will be able to manually restore automatic execution and end queuing even if outgoing commitments have neither been processed nor expired to prevent delays in order handling on the Amex that are beyond the Exchange's control.

[23] For example, *see* Exchange Rule 170, Commentaries .01, .02 and .04.

[24] Qualifying trades are trades with orders qualifying for revenue sharing. Qualifying orders are those delivered electronically from off the floor of the Exchange, excluding orders for Index Shares.

specialists fulfill their affirmative obligations. For these reasons, the Exchange (and the Commission) have not developed standardized criteria to assess the performance of specialists with respect to their affirmative obligations.

In contrast to the absence of concrete guidelines with respect to specialists' affirmative obligations, there are a variety of trading rules that circumscribe the ability of specialists to trade and therefore, define specialist negative obligations. These rules include Amex Rules 126, 154, 155, 170(c), (d) and (e), Commentaries .01, through .09 to Rule 170, and 175. Some of these rules are generally applicable to members (*e.g.*, Rule 126 which prescribes rules of priority, parity and precedence) while other rules are specific to specialists (*e.g.*, Rule 155). In particular, Commentaries .01, .02 and .07 to Rule 170 identify transactions characterized as ''destabilizing'' (*i.e.*, purchases on plus or zero-plus ticks and sales on minus or zero minus ticks) and circumscribe a specialist's ability to trade on destabilizing transactions.

When Congress first adopted the Exchange Act, Congress delegated to the Commission broad authority to regulate specialists. As originally enacted, Section 11(b) of the Act provided in part that *if* the Commission were to adopt rules permitting specialists to act as dealer, such rules would, ''restrict his dealings so far as practicable, to those reasonably necessary to permit him to maintain a fair and orderly market.'' In 1937, the Commission issued an interpretation (the ''Saperstein Interpreation'') with respect to specialists and their functions.[25] It avoided hard and fast rules and defined permitted transactions under the statutory standard as those which enhanced price continuity and minimized the effects of imbalances between supply and demand.

The Commission did not use its rule making authority under Section 11(b) until 1964, when it promulgated Rule 11b–1.[26] The rule was a result of the SEC's finding in the *Report of Special Study of Securities Markets*,[27] and was the product of intensive negotiations between the Commission and the primary exchanges. Rule 11b–1 includes both the specialist's affirmative and negative obligations.[28] The Exchange adopted paragraphs (b), (c), (d) and Commentaries .01 and .02 to Rule 170 in January 1965 soon after the adoption of Exchange Act Rule 11b–1.

In 1975, Congress amended section 11(b) of the Act *and entirely deleted the prior statutory limitation on specialist dealing.* The Senate Committee Report of the legislation stated that the limitation on specialist dealing might become unnecessary with the evolution of the National Market System and, specifically, ''active competition among market makers,'' and the elimination of the specialists ''trading advantages.''[29] Congress, accordingly, gave the SEC flexibility to eliminate the restrictions on specialist dealing when the looked-for changes in the National Market System occurred. The Commission, however, has not substantively amended Rule 11b–1 since its adoption in 1964.[30]

In 1991, the SEC approved NYSE rule change to permit specialists to reduce dealer positions on zero minus or zero plus destabilizing ticks *without* Floor Official approval, and to reduce dealer positions on straight plus and minus destabilizing ticks *with* Floor Official approval, provided that the specialist reentered the market following the liquidating transaction on the opposite side of the market from the liquidating trade.[31] In 1994, the SEC approved similar rule change for the Amex.[32]

It has been almost 25 years since Congress amended the Act to eliminate the statutory restriction on specialists dealing, and approximately 35 years have elapsed since the adoption of Rule 11b–1 in its present form. During this time, there have been tectonic changes to securities trading in the U.S., and the two preconditions to the elimination of the restrictions on specialist dealing identified by Congress, *i.e.*, the ''elimination of specialist trading advantages'' and ''active competition among the market makers,'' have occurred. The explosion in trading volume, proliferation of trading venues, nearly instantaneous dissemination of market information, development of electronic order routing and execution facilities, and implementation of the consolidated tape have substantially eroded the time and place advantage enjoyed by specialists in the mid-1970s and earlier. In addition, much of the specialist's perceived trading advantage derived from special access to the limit order book.[33] To the extent that any such advantage persists today, it would be significantly eroded in the New Equity Market Structure by the proposed ''look at the book.''

Specialists today face substantially greater competition from other market makers and liquidity providers than they faced in 1975 when Congress struck the restruction on specialist dealing from the Act. Off-Board trading restrictions are largely inapplicable to the Exchange's current equity list and third market makers and regional exchanges now trade substantial portions of the consolidated volume in Exchange listed stocks and constitute an even higher percentage of the trades. Block positions, derivatives markets and alternative trading systems also provide investors with sources of liquidity and

[25] Exchange Act Release No. 1117, March 30, 1937.

[26] Exchange Act Release Nos. 7432 (September 24, 1964), 29 FR 13777 (October 6, 1964) (proposing Rule 11b–1); and 7456 (November 23, 1964), 29 FR 15862 (adopting the Rule).

[27] *Report of Special Study of Securities Markets of the Securities and Exchange Commission*, 88th Congress, 1st Session, House Document No. 95, 1963 (hereinafter ''Special Study of Securities Markets'').

[28] In relevant part, Rule 11b–1(a) states:

(2) The rules of a national securities exchange permitting a member of such exchange to register as a specialist and to act as a dealer shall include:

(ii) Requirements, as a condition of a specialist's registration, that a specialist engage in a course of dealings for his won account to assist in the maintenance, so far as practicable, of a fair and orderly market, * * *

(iii) Provisions restricting his dealings so far as practicable to those reasonably necessary to permit him to maintain a fair and orderly market * * *.

[29] The Senate Committee Report states:

The present requirement in Section 11(b) that a specialist's dealing must be limited to those transactions 'reasonably necessary to permit him to maintain a fair and orderly market' would be eliminated. This change does not reflect a belief on the Committees' part that this present limitation of specialist dealing is inappropriate. The change is merely intended to provide the SEC with greater flexibility in prescribing a specialist's obligations in a national market system. It might well be that with active competition among market makers and the elimination of the trading advantages specialists now enjoy, such a restriction on specialists' dealings would become unnecessary. Because trading patterns and market making behavior in the context of a national market system cannot now be predicted, it appears appropriate to expand the Commission's rulemaking authority in this area so that the Commission may define responsibilities and restrict activities of specialists in response to changing conditions in the markets.

Senate Committee Report No. 94–75, page 100 (1975).

[30] In 1981, the Commission amended Rule 11b–1 to clarify that it also applied to options specialists and to eliminate duplicative SRO rule filing requirements. *See* Exchange Act Release No. 17574 (February 25, 1981), 46 FR 15134 (March 4, 1981).

[31] *See* Exchange Act Release No. 29626 (August 29, 1991), 56 FR 43949 (September 5, 1991) (approving SR–NYSE–91–07). The SEC permanently approved the rule changes in 1993. *See* Exchange Act Release No. 31797 (January 23, 1993), 58 FR 7277 (February 5, 1993).

[32] *See* Exchange Act Release No. 33957 (April 22, 1994), 59 FR 22188 (April 29, 1994) (temporarily approving SR–Amex–92–26). The SEC permanently approved the rule changes in 1997. *See* Exchange Act Release No. 38379 (March 10, 1997), 62 FR 13918 (March 24, 1997).

[33] *See* H.R. Report No. 1383.73rd Congress, Second Session, April 27, 1934, pages 14 and 15. The *Special Study of Securities Markets*, Part 2 at page 77 states:

Thus, in executing his brokerage functions, the specialist has a powerful tool [the limit order book] available to him only, giving him insight into the possible course of the market.

trading venues for Exchange listed securities that were unavailable or undreamed of the mid-1970s. With the erosion of commission income, specialists have had to rely increasingly upon trading revenues to survive, and rules that impede their ability to trade, but are inapplicable to their competitors,[34] threaten their competitive position. In addition, the Exchange's market surveillance capabilities have substantially increased in the last quarter entry. The Exchange, accordingly, is better able to identify and address inappropriate specialist activity when it occurs, and the need for prophylactic restrictions on specialists trading has been correspondingly reduced.

The Exchange believes that the elimination of the stabilization rules with respect to securities traded under the New Equity Market Structure will benefit investors by enhancing the ability of specialists to comply with their affirmative obligations to the modern, fast moving market by allowing them flexibility to manage their inventory. For example, assume that a specialists is long 5,000 shares of a stock that typically trades 50,000 shares per day. A brokerage firm publishes an initial ''buy'' recommendation on the stock and there is a predictable influx of buy orders. In this situation, the price of the stock would rise and the specialist would sell out of inventory to supply the demand. If a seller were to enter the market and the specialist were permitted to buy on a plus or zero (destabilizing) tick, the specialist could replenish its inventory and be in a position to better fulfill its affirmative obligations to the market. As matters stand now, however, the specialists is precluded from increasing its position on a destabilizing tick without obtaining Floor Official approval. In the time it would take to locate and obtain Floor Official approval, the offered stock would be purchased by another buyer. The specialists in the example thus would be unable to effectively manage its inventory to respond to changed market conditions.

It is important to note that the Exchange is not proposing the complete elimination of specialist negative obligations (even though Congress gave the Commission explicit authority to do so in 1975 in contemplation that the changes due to the advent of the National Market System would make such restrictions unnecessary). Instead, the Exchange is proposing to eliminate trading rules of the sort never applied by the Exchange and Commision in the context of specialist affirmative obligations. Thus specialists would be permitted under the Exchange's proposal to deal for their account without reference to the ''tick'' of the trade[35] and without the time consuming and duplicative review of a Floor Official. Specialists, however, would remain subject to the general negative obligation that they may not effect a principal transaction unless it is reasonably related to the maintenence of a fair and orderly market.[36] Specialists also would remain bound by the numerous other rules that circumscribe their dealer activity. Potential concerns with inappropriate specialist trading in the absence of the stabilizing rules should be addressed by the Exchange's review of specialist dealer activity to determine if it complies with the negative obligation and other rules applicable to specialist trading.

The Exchange also believes that the trading restrictions of Commentary .08 to Rule 154 (which requires specialists to obtain Floor Official approval prior to effecting trades at specified variations from the last sale) whould be modified to expand the price variations that require Floor Official approval. The current two dollar (for securities trading at $20 or more per share), one dollar (for securities trading between $10 and $20), and half dollar (for securities trading below ten dollars per share) price parameters have become too restrictive given the increasing speed of trading, and the Exchange proposes that the parameters be expanded to three, two and one dollar for stocks in the respective price ranges.

2. Basis

The proposed rule change is consistent with section 6(b) of the Act in general and furthers the objectives of section 6(b)(5) in particular in that the proposed New Equity Market Structure and assocaited rule changes are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with person engaged in regulating, clearing, settling, processing informaiton with respect to, and facilitating transactions in securities, to remove impediment 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. The proposed rule change also is consistent with section 11A of the Act in that it enhances (i) economically efficient execution of securities transactions, (ii) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets, (iii) the availability to brokers, dealers, and investors of informaiton with respect to quotations for and transactions in securities, (iv) the practicability of brokers executing investors' orders in the best market, and (v) an opportunity, consistent with the provisions of clauses (i) and (iv), for investors orders to be executed without the participation of a dealer.

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

The Exchange does not beleive 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

Written comments on the proposed rule change were neither solicited nor received.

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, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

[34] In the Release adopting Rule 11b–1, the Commission exempted specialists on regional exchanges from the requirements of the Rule. *See* Exchange Act Release no. 7465 (November 23, 1964), 29 FR 15862. In 1981, the Commission modified the exemption to apply Rule 11b–1 to regional exchanges with respect to such of their securities that are not listed on the Amex or NYSE. *See* Exchange Act Release No. 18157 (October 7, 1981), 46 50639 (October 14, 1981). The regional exchanges currently have rules that apply the general specialists affirmative and negative obligations to their specialists. They have not, however, applied stabilizing rules to their specialists. *See* Philadelphia Stock Exchange Rule 203, Chicago Stock Exchange Article XXX, Rule 1, and Pacific Exchange Rules 5.29(f) and 5.33(a).

[35] Specialists would remain subject to the Commission's short sale rule notwithstanding the proposed rule change.

[36] Amex Rules 170(c) and (d).

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange commission, 450 Fifth Street, NW, Washington, DC 20549–0609. 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, located at the above address. Copies of such filing will also be available for inspection and copying at the principal office of the self-regulatory organization. All submissions should refer to File No. SR–Amex–99–08 and should be submitted by July 14, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[37]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–15967 Filed 6–22–99; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41535; SR–DTC–99–16]

Self-Regulatory Organizations; The Depository Trust Corporation; Notice of Filing of Proposed Rule Change Relating to Profile Modification Feature of the Direct Registration System

June 17, 1999.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on June 17, 1999, The Depository Trust Corporation (''DTC'') filed with the Securities and Exchange Commission (''Commission'') the prosed rule change as described in Items I, II, and III below, which items have been prepared primarily by DTC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

[37] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

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

The purpose of DTC's filing is to resolve an impasse among members of the securities industry relating to the implementation of the Profile Modification System feature of the Direct Registration System.

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

In its filing with the Commission, DTC 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. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.[2]

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The purpose of this filing is to resolve an impasse among members of the Securities Transfer Association (''STA'') and the Securities Industry Association (''SIA'')[3] relating to the delay in implementing the Profile Modification System feature (''Profile'')[4] of the Direct Registration System (''DRS'').[5] Profile will allow a participant upon instructions from the participant's customer to electronically request a ''DRS limited participant''[6] to move the customer's DRS share positions to the participant's acount at DTC.[7] Profile will be available over both DTC's Participant Terminal System (''PTS'') and DTC's Computer-to-Computer Facility (''CCF'').

Representative member of the STA have reported that some of their members may not be able to implement Profile until some time in calendar year 2000. Members of the SIA had envisioned that Profile would be implemented during the third quarter of 1999. Becuase of differing views on the implementation schedule for Profile, there is no industry consensus on whether DRS should continue to operate as it does today[8] or whether use of DRS should be restricted in some manner until Profile is fully implemented.

If DRS is to continue to operate as it does today, there are several ways to handle making additional securities issued eligible for inclusion in DRS. The options include:

(1) If all ''DRS limited participants'' are not able to implement Profile by August 31, 1999, no additional securities issues would be made eligible after August 31, 1999, for inclusion in DRS until sometime in the first quarter of 2000 when all ''DRS'' limited participants'' are able to implement Profile using either PTS or CCF;

(2) securities issues would continue to be made eligible for inclusion in DRS in the manner in manner in which they are currently made eligible for inclusion; or

(3) securities would continue to be made eligible for inclusion in DRS provided that each ''DRS limited participant'' could be the ''DRS limited participant'' for no more than two new issues per month. If all ''DRS limited participants'' are not able to implement Profile by using PTS and CCF by March 31, 2000, no additional securities issues would be made eligible for inclusion in DRS until such time as all ''DRS limited participants'' are ready to use Profile.

DTC requests that the Commission staff provide guidance on the above options or any other option not described in this filing.

DTC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to DTC because the proposed rule change is designed to further the perfection of the mechanism for the national system for the prompt and accurate clearance and settlement of securities transactions.

[2] The Commission has modified the text of the summaries prepared by DTC.

[3] The STA and the SIA are two member groups on the DRS Committee, which is an industry responsible for designing DRS. The other members include Corporate Transfer Association and DTC.

[4] Profile is an electronic communication system through DTC which allows participants and DRS Limited Participants to send instructions to each other regarding the movement of DRS shares.

[5] See Securities Exchange Act Release No. 35038 (December 1, 1994), 59 FR 63652 (concept release relating to the direct registration system); Securities Exchange Act Release No. 37931 (November 7, 1996), 61 FR 58600 [File No. SR–DTC–96–15] (order relating to the establishment of DRS).

[6] For a description of ''DRS limited participants,'' refer to Securities Exchange Act Release No. 37931 (November 7, 1996), 61 FR 58600 [File No. SR–DTC–96–15].

[7] Profile will also allow a ''DRS limited participant'' upon instructions from a customer to electronically request a participant to move the customer's share positions to a ''DRS limited participant's'' account.

[8] Because ''DRS limited participants'' are currently not using Profile to receive instructions, brokers or their customers must submit requests to move DRS shares by sending a medallion guaranteed transaction advice to the ''DRS limited participants.''