

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41866; File No. SR-Amex-99-23]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the American Stock Exchange LLC Relating to the Amendment of Commentary .05 to Rule 155

September 13, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 9, 1999, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change. The Exchange submitted Amendment No. 1 to its proposal on August 2, 1999.³ The proposed rule change, as amended, is 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

Under the proposal, a member seeking to break an equity or option trade⁴ must first obtain written Floor Official approval. The member seeking the rejection must show good cause for the Floor Official to form the belief that the execution was inconsistent with the specialist's responsibility to maintain a

fair and orderly market. The text of the proposed rule change is as follows. New text is italicized and deleted text is bracketed.

Exchange Rule 155

* * * * *

.05(i) If a specialist elects to take or supply for his own account the securities named in an order entrusted to him by another member or member organization, such member or organization shall be so notified as follows:

(a) If such securities were named in an order received by the specialist through the Post Execution Reporting ("PER") System or the Amex Options Switch ("AMOS") System, the Exchange shall furnish a report of the transaction; or

(b) If such securities were named in an order received by the specialist in any other manner, the specialist shall indicate on the copy of the order ticket to be returned to the member or member organization that he executed the order as principal.

(ii) A member or member organization that seeks to [may] reject a transaction for which notice is required to be furnished pursuant to paragraph (i) above shall request Floor Official review of the transaction in writing promptly after receiving such notice and shall advise [by so advising] the relevant specialist in writing contemporaneously with the request for review [promptly after receiving such notice]. Any such written request for review [rejection] shall be given to the Floor Official and specialist by a member, not by a clerk. The transaction may only be rejected upon written Floor Official approval for good cause shown in relation to the specialist's responsibility to maintain a fair and orderly market. Any transaction not rejected in this manner shall be deemed accepted.

* * * * *

(b) Not applicable.

(c) Not applicable.

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 Exchange 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 Exchange 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

Since at least 1926, the Amex has had rules that allow specialists to act as both agent and principal on trades, but permit the brokers that placed the orders to reject the resulting contracts.⁵ Such rules always have required (i) a report advising the member that gave-out the order that the specialist acted as principal on the trade, and (ii) an opportunity for the member that gave-out the order to reject the contract. The genesis of the Amex and similar New York Stock Exchange ("NYSE") rules⁶ goes back to the turn of the century and traditional concepts of agency law that an agent cannot deal for its account against its principal absent the principal's consent.

There have been many changes in the securities market since the early part of this century. Of particular importance, the dissemination of information regarding trades and quotes is now nearly instantaneous and permits both market professionals and public investors to monitor the market and the quality of their executions. Brokers have developed sophisticated systems for reviewing execution quality in response to the Commission's statements on "best execution" of customer orders. The Exchange also has developed

⁵ Section 1 of Chapter XI of the Rules of the New York Curb Exchange (a predecessor of the Amex) in the July 1926 "Constitution of New York Curb Exchange and Rules Adopted by the Board of Governors Pursuant Thereto" provides in part:

No regular member, while acting as a broker, whether as a specialist or otherwise, shall buy or sell, directly or indirectly, for his own account or for that of a partner, or for any account in which either he or a partner has a direct or indirect interest, securities, the order for the sale or purchase of which has been accepted for execution by him, or by his firm, or by a partner, except as follows: . . .

[Exception (b)]. A regular member may only take the securities named in the order, provided that he shall have offered the same in the open market, if bonds at 1/8 of 1%, and if stocks at the minimum fraction of trading, above his bid, and provided that the price is justified by the conditions of the market, and that the member who gave the order shall directly, or through a broker authorized to act for him, after prompt notification, accept the trade and report it.

[Exception (c)]. A regular member may only supply the securities named in the order, provided that he shall have bid for the same in the open market, if bonds at 1/8 of 1%, and if stocks at the minimum fraction of trading, below his offer, and provided that the price is justified by the conditions of the market, and that the member who gave the order shall directly, or through a broker authorized to act for him, after prompt notification, accept the trade and report it.

⁶ The NYSE has a rule similar to Amex rule 155. See Amendment No. 1, *supra* note 3 (interpreting rules of other exchanges).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange clarified that Amex Rule 155 applies to all securities transactions on the Amex, revised and expanded its discussion of the rules of the other exchanges, and provided an example of what constitutes good cause for rescinding a trade. Letter from William Floyd-Jones, Assistant General Counsel, Legal & Regulatory Policy, Amex, to Terri Evans, Attorney, Division of Market Regulation, Commission, dated July 29, 1999 ("Amendment No. 1").

⁴ Amex Rule 155 generally applies to securities transactions on the Exchange. Amex Rule 950(a) specifically extends Rule 155 to options trading. The proposed rule change, accordingly, will apply to all securities trades effected on the Amex, including options. See Amendment No. 1, *supra* note 3.

sophisticated surveillance systems backed by extensive staff resources for reviewing trading by its members. These facilities were unavailable and inconceivable at the beginning of the century. At that time, the coarse approach of allowing one party to a trade to renege if the executing specialist acted both as agent and principal may have created an appropriate "in terrorem" effect. Today, however, a discretionary and unchecked unilateral right of rescission is excessive.

The Philadelphia Stock Exchange ("Phlx") amended its rules in 1993 to permit rescission of options trades only when the cancellation is approved in writing by a floor official, "for good cause shown."⁷ The Exchange's proposed rule change is based upon the Phlx's 1993 amendment to its rules.

The Amex rule that permits a party to an Exchange contract to break it, even though the execution may have been consistent with the market at the time of trade, interjects an element of financial risk into the market. This risk is magnified in the context of options due to the leverage of these securities. In the Exchange's view, the risk of financial instability created by giving persons an unfettered right to cancel trades merely because the executing specialist acted both as principal and agent outweighs whatever residual benefits the Rule may have. The Exchange, moreover, is not proposing to eliminate a member's ability to rescind a trade where the specialist may have acted inappropriately. The proposed rule change simply aims at eliminating the unchecked right to break trades due to the capacity in which the specialist acted.

Under the proposal, a member seeking to break an equity or option trade⁸ must first obtain written Floor Official approval. The member seeking the rejection must show good cause for the Floor Official to form the belief that the execution was inconsistent with the specialist's responsibility to maintain a fair and orderly market. For example, assume the market is 9 to 9¼, 1,000 by 1,000, and the specialist holds a sell stop order for 800 shares with an electing price of 9. Assume that the specialist sells 1,000 shares for its principal account at 9, and then executes the sell stop order at 8¾, buying 800 shares for its account. In this circumstance, it would be appropriate to

break the trade at 8¾ since, when a specialist's trade elects a stop, the specialist is required to fill the stop order at the price of the electing transaction (in this case at 9).⁹ The Exchange believes that the proposal appropriately limits the financial risk of specialists that provide liquidity to investors by acting as principal while maintaining the ability of members to break trades where the specialist acts inconsistently with his or her obligations.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act¹⁰ in general and furthers the objectives of Section 6(b)(5)¹¹ 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 investor and the public interest. Moreover, the Exchange contends that the proposal is not designed to permit unfair discrimination between customers, issuers, brokers and dealers.

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

The proposed rule change will impose no burden on competition 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 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.

⁹ *Id.*

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

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 in Washington, DC. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Amex-99-23 and should be submitted by October 12, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41870; File No. SR-Amex-99-29]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by American Stock Exchange LLC Relating to Disclosures by Specialists Under Amex Rule 174

September 13, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (or "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 6, 1999, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Amex. The Commission is publishing this notice to solicit

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

⁷ See Securities Exchange Act Release No. 32922 (September 17, 1993), 58 FR 50062 (September 24, 1993) (amending Phlx Rule 1019, Commentary .05) and Amendment No. 1, *supra* note 3 (interpreting the rules of the other exchanges).

⁸ See Amendment No. 1, *supra* note 3.