

things, that they create the appearance of serious conflicts of interest between the business objectives of the self-regulatory organization and its statutory duties, and can compromise a broker's fiduciary obligation to achieve best execution of its customers' orders. However, given the institution of payment for order flow programs at all other options exchanges and the continuation of payment for order flow programs by some specialist and market making organizations, the Amex believes that it may be necessary to re-institute its payment for order flow program in order to respond to these competitive pressures. Notwithstanding the Amex's decision to reinstate a payment for order flow program, the Amex continues to urge the Commission to ban all forms of payment for order flow.

After thorough consideration, the Exchange has determined to reinstate its marketing fee program in a modified form effective June 2, 2003. The revenue generated by these marketing fees would be used to compete for order flow in equity options listed for trading on the Exchange. The fee would be imposed at a rate of \$.40 per contract on specialist and registered option trader transactions.

The Exchange has determined to collect the marketing fee on only those specialist and registered option trader transactions involving customer orders from firms that accept payment for directing their orders to the Exchange ("payment-accepting firms"). In addition, the specialists would be solely responsible for negotiating payment for order flow arrangements with payment-accepting firms. Specialists would not be required to negotiate with any payment-accepting firms. Accordingly, the marketing fee would be assessed only on those specialist and registered option trader transactions resulting from orders from customers of payment-

accepting firms with whom a specialist has negotiated a payment for order flow arrangement. If a specialist has negotiated a payment to a firm of less than \$.40 per contract, the difference between \$.40 and the actual payment would be refunded to the specialist and the registered options traders. In addition, the marketing fee would be assessed only on transactions of specialists and registered option traders with orders from customers of payment-accepting firms that are for 200 contracts or less.

The Exchange would not have any role with respect to the negotiations between specialists and payment-accepting firms. Rather, the Exchange proposes to collect and administer the payment of the fee collected on those transactions for which the specialist has advised the Exchange that it has negotiated with a payment-accepting firm to pay for the firm's order flow. The Exchange would provide general administrative support for the program; in particular, the Exchange would keep track of the number of qualified orders sent by a payment-accepting firm, bill specialists and registered options traders through their clearing firms, and issue payments to payment-accepting firms to reflect the collection and payment of the marketing fee. All of the funds generated by the fee would be used only for the purpose of paying the firms for order flow they send to the Exchange.

According to Amex, it is important to note that although specialist and registered option trader transactions resulting from customer orders from firms that do not accept payment for their orders are not subject to the fee, Exchange specialists and registered options traders would have no way of identifying prior to execution whether a particular order is from a payment-accepting firm, or from a firm that does not accept payment for their order flow.

In connection with the reinstitution of a payment for order flow program that is funded by an Amex marketing fee, the Exchange will issue an Information Circular to its members that emphasizes the disclosure and best execution obligations of members who accept such payment.

The Exchange believes that the marketing fee program would provide for the equitable allocation of a reasonable fee among Exchange members, and that it is designed to enable the Exchange to compete with other markets in attracting order flow in multiply traded options from firms that include payment as a factor in their order-routing decisions. Because the marketing fee would be collected only

on those transactions resulting from customer orders of a payment-accepting firm that the specialist has independently negotiated with to pay for that firm's order flow, the Amex believes that there would be a direct and fair correlation between those members who fund the marketing fee program and those who receive the benefits of the program.

The Amex states that, as the Commission knows, it strenuously objects to all forms of payment for order flow because it believes that they create an inappropriate and unnecessary appearance of conflict of interest between the business interest of receiving payment for order flow and the fiduciary duty to achieve best execution. The Amex believes that SRO-sponsored payment for order flow programs are particularly inappropriate because, in its view, the self-regulatory organization's statutory duty to oversee and enforce its members' best execution obligations with respect to their order-routing decisions, while simultaneously paying for the members' order flow, creates an obvious appearance of a conflict of interest. Nevertheless, the Exchange believes that this rule filing is consistent with the Act because it would allow the Exchange to maintain its competitive position in relation to other self-regulatory organizations that have in place either a Commission-approved payment for order flow program<sup>6</sup> or programs that have otherwise become effective under the Act. In addition, the Amex believes that the proposed marketing fee would serve to enhance the competitiveness of the Amex and its members and that this proposal therefore is consistent with and furthers the objectives of the Act, including specifically Section 6(b)(5) thereof,<sup>7</sup> which requires the rules of exchanges to be designed to remove impediments to and to perfect the mechanism of a free and open market and a national market system, and Section 11A(a)(1) thereof,<sup>8</sup> which reflects the findings of Congress that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure fair competition among brokers and dealers and among exchange markets.

## 2. Statutory Basis

The Amex believes the proposed rule change is consistent with Section 6(b) of

Secretary, Commission, dated October 28, 2002; letter from Michael J. Ryan, Jr., Executive Vice President and General Counsel, Amex, to Chairman Harvey L. Pitt, Chairman, Commission, and Cynthia A. Glassman, Harvey J. Goldschmid, Paul S. Atkins, and Roel Campos, Commissioners, Commission, dated November 19, 2002; letter from Michael J. Ryan, Jr., Executive Vice President and General Counsel, Amex, to Jonathan Katz, Secretary, Commission, dated November 19, 2002; letter from Michael J. Ryan, Jr., Executive Vice President and General Counsel, Amex, to Chairman Harvey L. Pitt, Chairman, Commission, and Cynthia A. Glassman, Harvey J. Goldschmid, Paul S. Atkins, and Roel Campos, Commissioners, Commission, dated January 31, 2003; letter from Salvatore F. Sodano, Chairman & Chief Executive Officer, Amex, to Harvey L. Pitt, Chairman, Commission, dated February 6, 2003; and letter from Salvatore F. Sodano, Chairman & Chief Executive Officer, Amex, to Harvey L. Pitt, Chairman, Commission, dated February 10, 2003.

<sup>6</sup> See Securities Exchange Act Release No. 43833 (January 10, 2001) 66 FR 7822 (January 25, 2001).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 15 U.S.C. 78k-1.