analysis of the Amex data and, in particular, of Rule 109's impact on limit orders on the specialist's book, before it can consider permanent approval thereof. To allow the Commission fairly and comprehensively to evaluate the Amex's use of its pilot procedures, without compromising the benefit that investors might receive under Rule 109, as amended, the Commission believes that it is reasonable to extend the pilot program until July 21, 1995.

First, the Amex's latest monitoring report indicates that approximately half of orders stopped in minimum fractional change markets received price improvement. The Commission, therefore, believes that the pilot procedures provide a benefit to certain investors by offering the possibility of price improvement to customers whose orders are granted stops in minimum fractional change markets. According to the Amex report, moreover, nearly all stopped orders were for 2,000 shares or less. In this respect, the amendments to Rule 109 should mainly affect small public customer orders, which the Commission envisioned could most benefit from professional handling by the specialist.

Second, the Amex states that the amendments to Rule 109 have not adversely affected customer limit orders existing on the specialist's book.[11] This conclusion is based on the Exchange's review of limit orders on the opposite side of the market at the time a stop was granted pursuant to this pilot program. As part of its one-day review of the ten stocks receiving the greatest number of stops, the Amex determined how often book orders which might have been entitled to an execution had the order not been stopped, in fact, were executed at their limit price by the close of the day's trading.[12] In addition to aggregated data, the Amex provided a detailed breakdown of the disposition of each order.

The Commission historically has been concerned that book orders may get bypassed when stock is stopped, especially in a minimum fractional change market.[13] Based on the Amex's prior experience, the Commission did not have sufficient grounds to conclude that this long-standing concern had been alleviated. The Commission acknowledges, however, that Amex's recent monitoring reports provide new information on this aspect of the pilot program. As a result, the Commission finds that additional time is necessary for the Commission to review such information and to ensure that Rule 109, as amended, does not harm public customers with limit orders on the specialist's book.

In terms of market depth, the Amex's monitoring report suggests that stock tends to be stopped in minimum fractional change markets where there is a significant disparity (in both absolute and relative terms) between the number of shares bid for and the number of shares offered.[14] That report also suggests that, given the depth of the opposite side of the market, orders affected by the Rule 109 pilot tend to be relatively small.[15] The Amex repeatedly has stated, both to the Commission [16] and to its members,[17] that specialists can only stop stock in a minimum fractional changed market when (1) an imbalance exists on the opposite side of the market and (2) such imbalance is of sufficient size to suggest the likelihood of price improvement.[18]

In the Commission's opinion, the Amex data generally supports its conclusions regarding market depth. The Commission continues to believe that the requirement of a sufficient market imbalance is a critical aspect of the pilot program.[19] When properly applied, such a requirement should help the Amex ensure that stops are only granted in a minimum fractional change market when the benefit (*i.e.*, price improvement) to orders being stopped far exceeds the potential of harm to orders on the specialist's book.[20]

Finally, the Amex report describes its efforts regarding compliance with the pilot procedures. To alleviate confusion about how to evidence Floor Official approval (which, as noted above, a specialist must obtain to stop any order for more than 2,000 shares, or a total of more than 5,00 shares for all stopped orders), the Exchange has developed new manual and automated reports, which serve as a written audit trail for surveillance purposes. As a result, the Commission believes that the Amex has sufficient means to determine whether a specialist complied with the amendments' order size and aggregate share thresholds and, if not, whether Floor Official approval was obtained for larger parameters. The Commission also notes the Amex's ongoing effort to keep its specialists properly informed about the pilot program's requirements. In this context, the Amex has distributed Information Circulars,[21] and held continuing educational sessions on the pilot program and its requirements for stopping stock in minimum fractional change markets. The Commission would expect the Amex to take appropriate action in response to any instance of specialist non-compliance with Rule 109's procedures.

During the pilot extension, the Commission requests that the Exchange continue to monitor the effects of stopping stock in a minimum fractional change market and to provide additional information where appropriate. Moreover, if the Exchange determines to request permanent approval of the pilot program or an extension thereof beyond July 21, 1995, the Amex should submit to the Commission a proposed rule change by April 1, 1995.

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[11] When stock is stopped, book orders on the opposite side of the market that are entitled to immediate execution lose their priority. If the stopped order then receives an improved price, limit orders at the stop price are bypassed and, if the market turns away from that limit, may never be executed.

As for book orders on the same side of the market as the stopped stock, the Commission believes that Rule 109's requirements make it unlikely that these limit orders would not be executed. Under the Amex's pilot program, an order can be stopped only if a substantial imbalance exists on the opposite side of the market. See *infra,* text accompanying notes 14–20. In those circumstances, the stock would probably trade away from the large imbalance, resulting in execution of orders on the book.

[12] Beyond the one-day review, the Amex could make this determination only for those stocks in which the electronic display book had been implemented. For other stocks, the Amex determined how often an equivalent volume (*i.e.*, the same number of shares as the stopped order) was executed at the opposite side's limit price by the close of the day's trading.

[13] *See, e.g.,* SEC, Report of the Special Study of the Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. 2 (1963).

[14] There is a direct relationship between such a quote size imbalance and the likelihood of price improvement. A large imbalance on one side of the market suggests that subsequent transactions will take place on the other side. In those circumstances, it could be appropriate to grant a stop, since the delay might allow the specialist to execute the order at a better price for the customer.

[15] A relatively large order might begin to counteract the pressure the imbalance on the opposite side of the market is putting on the stock's price. Accordingly, it might not be as appropriate to stop such an order.

[16] See letter from Claire P. McGrath, Senior counsel, Legal & Regulatory Policy Division, Amex, to Mary Revell, Branch Chief, Division of Market Regulation, SEC, dated January 6, 1992 (Amendment No. 1 to File No. SR–Amex–91–05). Amendment No. 1 formally incorporated the requirement that the indicia of market depth discussed below must, without exception, be satisfied before a specialist is permitted to stop stock in a minimum fractional change market.

[17] See Amex Information Circular Nos. 92–74 (April 24, 1992) and 93–333 (April 7, 1993).

[18] For further discussion of the relationship between quote size imbalance and the likelihood of price improvement, see *supra* note 14.

[19] In extending a comparable pilot program on the New York Stock Exchange, the Commission placed similar emphasis on the critical nature of the sufficient size standard when stopping stock in minimum fractional change markets. See Securities Exchange Act Release No. 33791 (March 21, 1994), 59 FR 14437 (March 28, 1994) (File No. SR–NYSE–94–06).

[20] See *supra,* text accompanying notes 11–13.

[21] See *supra,* note 17.