VIA: FEDERAL EXPRESS

November 4, 2003

Mr. Jonathan Katz, Secretary
Securities and Exchange Commission
450 5th Street, NW
Washington, DC 20549

Re: SR-Amex-2003-81 & SR-Amex-2003-18 – Amex Closing Call in Nasdaq Issues Traded UTP

Dear Mr. Katz:

Citigroup Global Capital Markets, Inc. ("CGMI" or the "Firm")[1] is pleased to submit this comment letter in response to American Stock Exchange ("Amex") proposal SR-Amex-2003-81, which relates to the stop stock modifier to be used for Amex's single-price close in Nasdaq securities traded on an unlisted trading privileges basis ("UTP"). This comment letter also addresses the broader issues raised by rule filing SR-Amex-2003-18, in which Amex established a single-price close for Nasdaq issues traded on Amex UTP. As outlined below, Amex's single-price close raises significant investor protection, market structure, and regulatory concerns. While CGMI strongly supports competition among the markets, we believe that the Commission must address these concerns before it permits Amex to implement the single-price close for select Nasdaq securities. Accordingly, we urge the Commission to delay approval of SR-Amex-2003-81, and in turn the recently announced Standard & Poors pilot (described below), until Amex completely addresses the issues raised below.

Background. In March 21, 2003, Amex proposed to amend its rule to establish a single-price close for Nasdaq-listed securities that Amex trades on a UTP basis.[2] The proposal, which the Commission approved on an *accelerated basis* on April 10, 2003, amended Amex's existing rules so that the closing-market procedures that previously applied only to Amex-listed equities now apply to Nasdaq-listed issues that Amex trades UTP. Under Amex rules, if there is an imbalance between the buy and sell market-at-the-

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[1] CGMI is an indirect wholly owned subsidiary of Citigroup, Inc. CGMI is a registered Nasdaq market maker in approximately 800 Nasdaq-listed securities. CGMI is a member in good standing with the American Stock Exchange, and a number of other self-regulatory organizations/national securities exchanges. In addition, CGMI and its affiliate firms transact securities business in more than 34 countries.

[2] See Exch. Act Rel. No. 34-47658 (SEC File No. SR-Amex-2003-18) (order granting accelerated approval to Amex single price close for Amex's Nasdaq UTP program).

close orders, the Amex specialist must execute the imbalance against the *Amex* best bid or best offer – not the national best bid or best offer.[3] The Amex member then stops the remaining buy and sell orders against each other and pairs them off at the price of the immediately preceding sale (i.e., the price of the imbalance trade). The pair-off order is to be executed *at or as near to the close as practicable*. Under Amex rule proposal SR-Amex-2003-81, the "pair off" will be reported to the tape as a "stopped stock," and Amex separately will disseminate a price-only (i.e., no volume) official closing print.

On October 8, 2003 -- approximately six full months after the Commission approved Amex's closing rules -- Standard & Poors, Inc. ("S&P") announced that it was instituting a pilot under which S&P will cease using the primary market of Nasdaq to establish the official closing price for a subset of Nasdaq-listed securities that are part of the S&P 500 index. Rather, under the pilot program S&P will use the official closing price established by Amex's single-price close for the 12 pilot stocks.

Inadequate Notice to the Public of Market Closing Rules. The Commission should not approve SR-Amex-2003-81 without providing market participants with a thorough opportunity for public comment. We believe the public has not had adequate notice of Amex's proposal to establish a single-price close for Nasdaq securities. When Amex proposed to establish a single price close for Nasdaq issues in March 2003, no index provider, fund complex or pricing agent used or had announced plans to use the Amex close for pricing purposes. Given that one of the most influential and largest index providers has recently announced it will switch from the primary market to Amex, the public was not able to understand the magnitude of Amex's closing auction proposal when it was first published for comment and approved. There are significant market structure implications with allowing a non-primary, non-automated market to establish an official closing price for Nasdaq securities.[4] The public must have the ability to fully digest and comment on Amex's closing- price rules and procedures in light of the S&P's unprecedented move. Stated simply, the Amex's proposal exposes the market to serious risk and exposes investors to substantial harm. It would be irresponsible for the Amex and the Commission to permit the proposed change to occur without more analysis of the proposed structure.

The standards for establishing the closing price on Amex are vague, and consequently provide opportunity for mis-pricing and front running. The rules require the Amex specialist to print the imbalance within the Amex best bid / best offer. There is no requirement in rules or as a matter of practice that the Amex best bid or best offer be related to the national best bid or best offer or be related to the price at which a majority of the liquidity is trading. Thus, the Amex specialist could publish an extremely wide quote at the close (e.g., a dollar spread) and have discretion to print the imbalance

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[3] An imbalance of buy orders is executed against the offer. An imbalance of sell orders is executed against the bid.

[4] Amex's closing auction rules were subject to virtually no public comment. Amex's rules were approved on an accelerated basis, with no comment period prior to publication and approval. Additionally, Amex's rules were approved at a time when relevant facts (i.e., that S&P would utilize Amex's closing price) were not known or disclosed to the public.

anywhere within that wide range. In fact, when CGMI asked an Amex specialist how he would establish the price at which they would print the closing block, the specialist gave the vague answer that he will try to do a good job for the stock. We believe that Amex rules and procedures, as approved, create more uncertainty and potential for harm to the market and investors because the obligations of the specialist are extremely unclear. Given that the Amex rules lack specific standards, we question how Amex regulatory staff will be able to enforce such rules. The Commission should require the Amex to define with a greater level of specificity how the specialist must determine the price at which it will execute the closing cross. Because the Amex transacts less than 1% of the volume in Nasdaq stocks, the specialist should be obligated to consider the quotes of away market centers and the prevailing market prices.

Manipulation and Front Running Concerns. The rules governing the Amex close are designed for an auction market environment where a substantial majority of the trading and price discovery occurs on the floor of the primary exchange. The Amex structure is unworkable in the Nasdaq environment where most of the price discovery occurs off the floor, in a decentralized, electronic trading environment.

In this connection, Amex rule changes described above raise concerns of manipulation and front running. Specifically, the rule changes grant monopoly power to Amex specialists during an extremely important price-discovery point. Amex will only publish an imbalance at 3:40 p.m., and will not have the capability to accurately communicate the projected clearing price of each auction. Thus, the Amex specialist will be the only market participant that knows the size of the imbalance after 3:40 p.m. or the expected closing price.[5] During the period leading up to the close and prior to the close, the Amex specialist presumably will be able to access liquidity in the Nasdaq market on an automated basis and trade against the orders in his or her book, while remaining otherwise inaccessible. In short, the specialist will have an informational advantage as well as unfettered access to the market, and will be able to trade against his/her orders going in to the close. Similarly, because the specialist is not required to put up its last print at 4:00 p.m. and will have access to after-hours trading that occurs in the ECNs, the Amex specialist have a free "look back" or option.[6] The specialist's information monopoly, along with the unilateral ability to set the price and decide when and how much to trade against that price, will create large price moves with the potential for the specialists to profit directly from those moves.

Operational and Technology Concerns. As the Commission is aware, Amex does not offer a fully automated interface to broker/dealers and market centers. Many orders are sent to Amex by phone and/or are manually processed. The Amex close and the S&P pilot will place extreme burdens upon Amex's systems if a significant portion of order flow to be priced at the close needs to be delivered to the exchange's floor. We

[5] Under Amex rules, all market on close and limit on close orders must be submitted are cannot be canceled after 3:40 p.m. The specialist will publish an imbalance at this time (3:40 pm.), but will not update the imbalance thereafter, thus giving the specialist a complete information advantage.

[6] Amex rules state that the specialist is only required to print the closing transaction "as soon as practicable" after 4:00 p.m.

have no assurances that Amex - either currently or in the near future - will have in place a system that can process the multitudes of orders and messages at close.

We also believe that the Amex close and the S&P pilot will place extreme burdens upon the operational areas of broker/dealers since firms will invariably be required to convert thousands of electronic tickets back to paper to accommodate Amex's market structure and technology. The result will be a dramatic increase in breaks and exceptions, which will increase costs to the broker/dealer community and investors. We question whether Amex has the technical capability, capacity or expertise to support the type of robust trading environment that could result from the S&P pilot and the broader Amex close. The Commission should require Amex to provide the Commission with written representations that it will have adequate technology capacity to meet the influx of orders at the close.

The Amex close and the S&P pilot also create operational difficulties related to processing and executing customer orders. As the Commission is aware, a single Nasdaq security can be included in multiple index products. Thus, when an institutional customer places an order with a firm, the customer will have to designate which index the order is meant to track and the related market off which the index is priced. In turn, firms will need to make routing decisions on an order-by-order basis. This creates both operational and technology challenges, which firms must address in an unrealistically brief period of time.

Similarly, the Amex close and the S&P pilot will exacerbate price fragmentation and frustrate transparency. Specifically, data vendors and media outlets will have the choice of three possible official closing prices to publish: the consolidated close; Nasdaq's NOCP; and the Amex close. This level of "price fragmentation" will surely cause confusion to institutional and retail investors, and as such is inconsistent with the goals of the Exchange Act.

Liquidity Dislocation. As noted above, Amex currently accounts for less than 1 percent of total Nasdaq volume. Amex is the only exchange that trades Nasdaq-listed securities without offering automated executions for all customer orders. The practical implication of this is that at 3:59 p.m. EST, the overwhelming majority of liquidity that is resident in the automated environments of Nasdaq, the Archipelago Exchange, and the ECNs, will need to suddenly shift to Amex. As illustrated in an example below, there can and will be significant price dislocation characterized by aberrant prices, trade-throughs, and locked/crossed markets.

Liquidity dislocation will have a negative effect on retail orders. Retail orders that are predominantly resident in the automated environment of Nasdaq and the ECNs will not be able to achieve the Amex close for the following reasons. First, it will be impossible to shift the liquidity from the automated environment to Amex because of the lack of efficient connectivity. Second, since Amex does not offer automatic execution, the market makers and ECNs that are representing retail orders will not be able to access Amex's quote or price at the close. Additionally, since Amex is not obligated to put up its closing price at 4:00 p.m., there is no practical way for broker/dealers or their customers to match the Amex close.

We are deeply concerned that the liquidity dislocation and the larger structural issues (lack of meaningful connectivity, no automatic execution, ability to delay dissemination of the closing price) will create bifurcated markets. Specifically, small investors that place their orders with retail firms, market makers, and/or ECNs will assuredly receive a quite different price than institutional customers who place their orders with Amex specialists. We believe that it is inconsistent with the Exchange Act to create bifurcated markets, and thus urge the Commission to take action to prevent such a result.

Regulatory Resources. We are deeply concerned that Amex will not have adequate resources to detect and deter front running, manipulation and other abuses. In fact, the Commission's own recent findings with respect to Amex's regulatory program causes us to question whether Amex has the appropriate regulatory systems and personnel needed to surveil for fraud, manipulation or other unethical conduct. We ask that the Commission examine the following questions before allowing Amex's program to go forward. Does Amex's regulatory staff have the ability to surveil for specialist trading occurring in away markets (e.g., the ECNs, Nasdaq, and the Cincinnati Stock Exchange, and the Alternative Display Facility) prior to and after the close? Does Amex's audit trail include trades that are routed to away markets? If trades are affected through away markets, what are the assurances that the Amex specialist will protect limit orders resident on the Amex book? Can Amex regulatory staff detect such limit order violations? Without an adequate regulatory infrastructure, both large and small investors alike, as well as the market's integrity, could be significantly harmed.

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As an illustration of the concerns outlined above, consider the following example. Assume the market in Stock ABCD at 3:40 p.m. is $20.00 to $20.02 and Amex publishes a sell imbalance of 75,000 shares at that time (e.g., 35,000 to buy, 110,000 so sell). Stock ABCD is included in the S&P 500 and is a pilot stock, and is also included in the Russell 1000 index. The stock moves during the last 20 minutes of trading and there are only 25,000 shares of offsetting buy orders on Amex. At 3:59:59 p.m., Amex has a sell imbalance of 50,000 shares (60,000 to buy, 110,000 to sell). At the close, the NBBO is $19.95 to $19.97; while Amex's quote is $19.90 to $20.01. Using multiple ECNs, the Amex specialist sells 50,000 shares of Stock ABCD at $19.97 either just before or shortly after the close. At 4:01:10 p.m., the specialist executes the 50,000-share imbalance a price of $19.90 – which represents the prevailing, albeit out of the market, Amex best bid. The Amex specialist then crosses the remaining 50,000 shares at the $19.90 price. By front running those orders, the Amex specialist earns a 7 cents spread on the 50,000-share imbalance.

As to concerns with bifurcated markets, dislocation and pricing fragmentation, consider that while all of the above trading is occurring on Amex, Nasdaq's NOCP closes at 4:00:02 at $19.96. Retail orders receive a price of or about $19.96, while institutional orders on Amex receive a closing price of $19.90. Additionally, those institutions whose portfolio track the Russell 1000 and use the NOCP will receive a closing price of $19.96, while those portfolios that track the S&P 500 will receive an Amex closing price of $19.90.

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In light of the above, the Commission should delay approval of SR-Amex-2003-81, and should delay the implementation of the S&P pilot in order to give firms as well as the public time to consider the operational, technology, regulatory, and market quality that we have highlighted.

We appreciate the opportunity to provide our views on this critical matter. If you have any question or wish to discuss this matter further, please feel free to contact David Weisberger, Managing Director, at 212-723-1331, John F. Malitzis, Associate General Counsel, 212-723-5875, or me.

Very truly yours,

James O'Donnell