SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50417; File No. SR-CHX-2003-07)

September 21, 2004

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendments No. 1 and 2 Thereto by the Chicago Stock Exchange, Incorporated Relating to Out-of-Range Execution Rules

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 March 20, 2003, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On March 10, 2004, the Exchange filed Amendment No. 1 to the proposed rule change,[3] and on September 15, 2004, the Exchange filed Amendment No. 2 to the proposed rule change.[4] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend CHX Article XX, Rule 37, which governs, among other things, "out-of-range" executions. The text of the proposed rule change, as amended, appears below. Additions appear in italics; deletions are in [brackets].

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1 15 U.S.C. 78s(b)(l).

2 17 CFR 240.19b-4.

3 See letter from Kathleen M. Boege, Vice President & Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 10, 2004 ("Amendment No. 1"). Amendment No. 1 clarified the purpose and effects of the proposal.

4 See letter from Kathleen M. Boege, Vice President & Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated September 13, 2004 ("Amendment No. 2"). Amendment No. 2 replaced the original proposal and Amendment No. 1 in their entirety.

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Chicago Stock Exchange Rules

ARTICLE XX

Guaranteed Execution System and Midwest Automated Execution System

RULE 37. (a) Guaranteed Executions.

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[6. Executions Outside of Range. Since executions are guaranteed on the basis of the size and price of the best bid or offering, the order may be executed out of the primary market range for the day but in a Dual Trading System issue a stop must be granted if requested.]

[7.]<u>6.</u> No change to text.

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(b) Automated Executions.

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(9) [All market orders received through the MAX System that would result in an out of range execution shall be deemed to be received with a request to STOP. Additionally, specialists may stop limit orders that are marketable when entered into the MAX System. Subject to Interpretations and Policies .03 under this Rule 37, a specialist may execute a stopped order out of the primary market range, at no worse than the stopped price, provided the specialist receives approval to do so from two floor officials.]

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(d) SuperMAX 2000

SuperMAX 2000 shall be a voluntary automatic execution program within the MAX System. SuperMAX 2000 shall be available for any security trading on the Exchange in decimal price increments. A specialist may choose to enable this voluntary program within the MAX System on an issue-by-issue basis.

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[(5) Out of Range. Notwithstanding anything herein to the contrary, SuperMAX 2000 will not automatically execute an order if such execution would result in an out of range execution.]

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… **Interpretations and Policies**

.01 No change to text.

.02 No change to text.

.03 Reserved for future use. [With regard to paragraph 6 of paragraph (a) of this Rule, in the case of a minimum variation market, a stopped sell order will not be filled until a transaction takes place at the bid price or lower on the primary exchange or the Exchange's displayed share volume at the offering has been exhausted. A stopped buy order will not be filled until a transaction takes place at the offering price or higher on the primary exchange or the Exchange's displayed share volume at the bid has been exhausted. Notwithstanding the foregoing, all orders stopped pursuant to this Interpretation and Policy .03 shall be executed by the end of the trading day on which such order was stopped at no worse than the stopped price.]

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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 CHX included statements concerning the purpose of and basis for the proposed rule change, and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The CHX 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend CHX Article XX, Rule 37, which governs, among other things, "out-of-range" executions. The Exchange's rules currently impose specific order handling requirements on specialists when the execution of an order would result in an out-of-range execution.[5] For example, Exchange rules require that market orders received through MAX®, the Exchange's automated routing and execution system that would result in an out-of-range execution are deemed received with a request to stop.[6] Under existing rules, a specialist may execute a stopped order out of the primary market range only with the approval of two floor officials.

This out-of-range rule likely was put in place at the request of customers, or as a marketing tool to attract new customers, when trading occurred in much larger minimum variations and when trading on regional exchanges was somewhat less common. Today, trading on regional exchanges is not a new phenomenon. Moreover, trading on all markets now occurs in a decimal trading environment, where an out-of-range execution based on the national best bid or offer is more readily seen by customers as accurately and appropriately reflecting the current market for the security. In addition, the existing rule can have the unintended – and in today's sometimes fast-paced trading environment – inappropriate result of delaying order executions

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5 An "out-of-range" execution is an execution that would create a new high or new low for the day when compared to the primary market range.

6 See CHX Article XX, Rule 37(b)(9).

when the specialist has stopped the order waiting for an opportunity to fill it within the primary market range.[7] For all of these reasons, the Exchange believes that it is no longer necessary to require that its specialists only fill orders within the primary market range for the day.

The proposed rule text would eliminate all references to specific order-handling responsibilities with respect to out-of-range executions.[8] Once the out-of-range functionality is eliminated from the Exchange's systems, an order that is eligible for automatic execution will be automatically executed by the Exchange's MAX system, even if it will constitute an out-of-range execution.

2. Statutory Basis

The CHX believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,[9] in general, and furthers the objectives of Section 6(b)(5) of the Act,[10] in particular, in that it is designed 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 investors and the public interest.

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7 Inadvertent violations of the current rule also require specialists to correct improper executions, which can be an inconvenience to the Exchange's order-sending firms who must send additional execution confirmations to their customers.

8 Deletion of the out-of-range provisions relating to the stopping of otherwise out-of-range orders may impact CHX Article XX, Rule 28, which deals with a CHX specialist's liability for stopped orders. The Exchange, based on discussions with the Commission, agrees that it is appropriate to clarify whether the practice of stopping stock should be permitted on the Exchange. If the Exchange's management, member committees and Board of Governors determines that this practice should be prohibited, the Exchange will effect such a rule change, including deletion of CHX Article XX, Rule 28, by means of a separate submission to the Commission. If the Exchange determines that it remains appropriate for CHX specialists to stop stock in certain limited circumstances, then the Exchange will submit a rule change to the Commission that would specifically define the circumstances under which stock may be stopped on the CHX, and specifically outlining appropriate CHX specialist conduct under such circumstances.

9 15 U.S.C. 78f(b).

10 15 U.S.C. 78f(b)(5).

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

The Exchange believes that no burden will be placed on competition as a result of the proposed rule change.

C. Self-Regulatory Organization's Statement on Comments Regarding the Proposed Rule Change Received from Members, Participants or Others

No written comments were either solicited or 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 its finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange 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.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send e-mail to rule-comments@sec.gov. Please include File No. SR-CHX-2003-07 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and

Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. All submissions should refer to File No. SR-CHX-2003-07. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). 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, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-CHX-2003-07 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[11]

Margaret H. McFarland
Deputy Secretary

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[11] 17 CFR 200.30-3(a)(12).