

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49437; File No. SR-CHX-2003-24)

March 17, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Incorporated Relating to the Definition of Primary Market

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 14, 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 January 29, 2004, the Exchange amended the proposed rule change.<sup>3</sup> 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(a)(3)(a), which governs execution of resting limit orders based on certain conditions in the primary market. Specifically, the proposed rule change would permit the Exchange’s Rules Subcommittee to designate the primary market in each listed issue for purposes of determining limit order execution guarantees to be offered on the CHX.

The text of the proposed rule change, as amended, is below. Proposed new language is

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Letter from Kathleen Boege, Associate General Counsel, CHX, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated January 28, 2004 (“Amendment No. 1”). Amendment No. 1 replaces and supersedes the CHX’s original 19b-4 filing in its entirety.

italicized; proposed deletions are in [brackets].

\* \* \* \* \*

**Rule 37**

(a) Guaranteed Executions

\* \* \* \* \*

(1) – (2) No change to text.

(3) Execution of Agency Limit Orders. Subject to Interpretation and Policy .10 (“Exempted Trade-Throughs”), all agency limit orders in Dual Trading System issues will be filled under the following circumstances:

(a) Exhaustion of primary market bid or offer. When the bid or offering at the limit price has been exhausted in the primary market (as designated by the Rules Subcommittee pursuant to Interpretation and Policy .07 [defined in the CTA Plan]), agency limit orders will be executed in whole or in part, based on the rules of priority and precedence, on a share for share basis with trades executed at the limit price in the primary market.

\* \* \* \* \*

**Interpretations and Policies:**

\* \* \* \* \*

.07 [[Reserved for future use]] Unless otherwise authorized by the Exchange’s Board of Governors, in designating the “primary market” for purposes of Rule 37(a)(3) of this Article XX, the Rules Subcommittee shall designate the initial listing market for a security as the primary market, unless that security is traded by either the New York Stock Exchange (“NYSE”) or the American Stock Exchange (“Amex”), in which case the primary market shall be the NYSE (for

the securities it trades) or the Amex (for the securities it trades). If a security is traded on both the NYSE and the Amex, whichever exchange is the initial listing market shall be designated as the primary market. If the initial listing market is a market other than the NYSE or the AMEX, but is traded by both the NYSE and the AMEX, the primary market shall be the market with the largest trading volume in the subject security, calculated on a twelve-month rolling basis.

\* \* \* \* \*

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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The proposed rule change would amend CHX Article XX, Rule 37(a)(3)(a), which governs execution of resting limit orders based on certain conditions in the primary market. Specifically, the proposed rule change would permit the Exchange's Rules Subcommittee to designate the primary market in each listed issue for purposes of determining the limit order execution guarantees to be offered on the CHX.

For many years, the CHX has guaranteed limit order protection, i.e., execution of limit orders at the limit price based on certain conditions in the primary market.<sup>4</sup> The current version of CHX Article XX, Rule 37(a)(3)(a) notes that the “primary market” is determined using the CTA Plan definition of that term. Under the CTA Plan, the primary market is the exchange where the greatest number of reportable transactions in a particular security have taken place during the preceding six-month period.<sup>5</sup> As described below, the Exchange no longer believes it is appropriate to base its limit order execution guarantees on that definition of a primary market.

The CHX believes that, as an initial matter, in today’s increasingly fragmented markets, the existing definition could result in a constant re-designation of the primary market, as trading moves from venue to venue. Moreover, the definition may cause the Exchange to provide CHX limit order executions that are not desired by the Exchange’s order-sending firms and the investors they serve. In many cases, customers may want their limit orders protected against the listing market for a security, not against another market that happens to have had the greatest number of transactions during a given time period. The CHX believes that at a minimum, continual re-designation of the primary market under the CTA Plan definition could prove

---

<sup>4</sup> Under the current version of CHX Article XX, Rule 37(a)(3), all agency limit orders must be filled at the limit price when one of three conditions occurs: (i) when the bid or offer in the primary market has been exhausted, CHX agency limit orders are executed at the limit price up to the volume of subsequent prints in the primary market; (ii) when there is a price penetration in the primary market, agency limit orders that have resided in the CHX specialist’s book for up to 15 seconds must be executed at the limit price; and (iii) when the issue is trading at the limit price on the primary market, CHX agency limit orders must be executed at the limit price unless it can be demonstrated that such orders would not have been executed at the limit price (or the broker and specialist agree to a specific volume-related or other criteria for requiring a fill).

<sup>5</sup> See Second Restatement of Plan Submitted to the Securities and Exchange Commission Pursuant to Rule 11A3-1 Under the Securities Exchange Act of 1934, as amended and restated (the “CTA Plan”), at Section XI(a)(ii).

extremely confusing to CHX order-sending firms and their customers. For these reasons, the Exchange believes that another definition of primary market is amply warranted.

Under the proposed change, the Exchange’s Rules Subcommittee would be given the authority to define the primary market for listed securities for purposes of determining the limit order execution guarantees offered on the Exchange. As an initial matter, the Rules Subcommittee intends to designate the initial listing market for a security as the primary market, unless that security is traded by either the New York Stock Exchange, Inc. (“NYSE”) or the American Stock Exchange LLC (“Amex”); if the security is traded by one of those markets, then the primary market would be the NYSE (for the securities it trades) and the Amex (for the securities it trades). If a security is traded on both the NYSE and the Amex, whichever of the two is the initial listing market would be designated as the primary market.<sup>6</sup> If the initial listing market is a market other than the NYSE or the Amex, but is traded by both the NYSE and the Amex, the primary market shall be the market with the largest trading volume in the subject security, calculated on a twelve-month rolling basis. The Exchange believes that the designation guidelines outlined above will ensure that the Rules Subcommittee consistently designates a market that is a significant source of liquidity, to the benefit of customers whose orders are routed to the CHX.

---

<sup>6</sup> If the Rules Subcommittee identifies a different designation for all listed securities traded on the Exchange, the Exchange will notify its order-sending firms of those Exchange-wide changes and file those changes with the Commission as an interpretation of an existing rule pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) thereunder. If, however, the Rules Subcommittee responds to the fragmentation in the market by identifying different designated markets for different securities, the Exchange will file, pursuant to Rule 19b-4(f)(1) under the Act, a new interpretation confirming that the Rules Subcommittee has identified different designated markets in different securities for purposes of this voluntary functionality, but will not list all of those different designations.

The Exchange already uses a similar method of defining the scope of the limit order protections provided for Over-the-Counter (“OTC”) securities. Under a proposal approved last year, each CHX specialist in an OTC security has the authority, with the approval of the Exchange, to identify, on an issue-by-issue basis, the designated market against which he or she will protect limit orders.<sup>7</sup> Through this filing, the Exchange seeks to implement a similar program for determining the scope of the limit order protections given to listed securities.

## 2. Statutory Basis

The CHX believes the proposal, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>8</sup> The CHX believes the proposal, as amended, is consistent with Section 6(b)(5) of the Act<sup>9</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments, and to perfect the mechanism of, a free and open market and a national market system, and, in general, to protect investors and the public interest.

### B. Self-Regulatory Organization’s Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

---

<sup>7</sup> See Securities Exchange Act Release No. 48014 (June 11, 2003), 68 FR 35923 (June 17, 2003) (SR-CHX-2003-05).

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

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 CHX 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-CHX-2003-24. 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to refer to File No. SR-CHX-2003-24, and should be submitted by [insert date 21 days from date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Margaret H. McFarland  
Deputy Secretary

---

<sup>10</sup> 17 CFR 200.30-3(a)(12).