

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49994; File No. SR-CHX-2004-20)

July 9, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by The Chicago Stock Exchange, Incorporated to Reinstate and Extend a Pilot Rule Interpretation Relating to Trading of Nasdaq/National Market Securities in Subpenny Increments

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 July 6, 2004, 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 and II, below, which Items have been prepared by the Exchange. The Exchange has filed this proposed rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comment on the proposed rule change from interested persons.

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

The Exchange proposes to immediately reinstate and extend through June 30, 2005, the pilot rule interpretation relating to the trading of Nasdaq/National Market securities in subpenny increments. The CHX represents that it does not propose to make any substantive or typographical changes to the pilot; the only change is to immediately

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

reinstate the pilot and extend its expiration date through June 30, 2005. The text of the proposed rule change is available at the Commission and at the CHX.

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 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

On April 6, 2001, the Commission approved, on a pilot basis through July 9, 2001, a pilot rule interpretation (CHX Article XXX, Rule 2, Interpretation and Policy .06 “Trading in Nasdaq/NM Securities in Subpenny Increments”)⁵ that requires a CHX specialist (including a market maker who holds customer limit orders) to better the price of a customer limit order in his book which is priced at the national best bid or offer (“NBBO”) by at least one penny if the specialist determines to trade with an incoming market or marketable limit order. The pilot, which was approved in conjunction with exemptive relief granted by the Commission to allow for trading in Nasdaq/NM securities

⁵ See Securities Exchange Act Release No. 44164 (April 6, 2001), 66 FR 19263 (April 11, 2001) (SR-CHX-2001-07).

in subpenny increments,⁶ has been extended eight times and expired on June 30, 2004.⁷ The CHX now proposes to immediately reinstate and extend the pilot through June 30, 2005. The CHX proposes no other changes to the pilot, other than immediately reinstating and extending it through June 30, 2005.

2. Statutory Basis

The CHX believes the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange,

⁶ In proposed Regulation NMS, the Commission proposed rules that would prohibit national securities exchanges, national securities associations, alternative trading systems, vendors, brokers and dealers from displaying, ranking, or accepting bids, offers or orders in subpenny increments in most covered securities. See Proposed Rule 612 under the Act. The CHX represents that nothing in proposed Regulation NMS, however, would prohibit trading in subpenny increments. As a result, the Exchange believes that its pilot rule would remain in place, through its proposed new date of effectiveness, if Regulation NMS were adopted in its current form. The Exchange recognizes, however, that the exemptive relief it has been granted – to allow the Exchange’s members to display their quotes in penny increments while trading in subpenny increments – would be superseded if Regulation NMS’s currently proposed provisions are adopted. The Exchange has stated that it will undertake to work with the Commission to ensure that the pilot program would be consistent with the rules and regulations contained in Regulation NMS, when it is adopted. Telephone conversation between Kathleen Boege, Vice President and Associate General Counsel, CHX, and Gordon Fuller, Counsel to the Assistant Director, Division of Market Regulation, Commission, on July 9, 2004.

⁷ See Securities Exchange Act Release Nos. 44535 (July 10, 2001), 66 FR 37251 (July 17, 2001) (extending pilot through November 5, 2001); 45062 (November 15, 2001), 66 FR 58768 (November 23, 2001) (extending pilot through January 14, 2002); Securities Exchange Act Release No. 45386 (February 1, 2002), 67 FR 6062 (February 8, 2002) (extending pilot through April 15, 2002); 45755 (April 15, 2002), 67 FR 19607 (April 22, 2002) (extending pilot through September 30, 2002); 46587 (October 2, 2002), 67 FR 63180 (October 10, 2002) (extending pilot through January 31, 2003); 47372 (February 14, 2003), 68 FR 8955 (February 26, 2003) (extending pilot through May 31, 2003); 47951 (May 30, 2003), 68 FR 34448 (June 9, 2003) (extending pilot through December 1, 2003); 48871 (December 3, 2003), 68 FR 69097 (December 11, 2003) (extending pilot through June 30, 2004).

and, in particular, with the requirements of Section 6(b).⁸ The CHX believes the proposal is consistent with Section 6(b)(5) of the Act⁹ 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.

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.

C. Self-Regulatory Organization's Statement on Comments on 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

The Exchange asserts that the proposed rule change is immediately effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and Rule 19b-4(f)(6) thereunder¹¹ because it: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with protection of investors and the public interest.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

The Exchange has requested the Commission to waive the 30-day operative delay and the five-day pre-filing notice requirement. The Commission believes waiving the 30-day operative delay is consistent with the protection of investors and the public interest because it will allow the pilot to be reinstated and continue uninterrupted through June 30, 2005.¹² The Commission has also determined to waive the five-day pre-filing notice requirement. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such proposed rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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 an e-mail to rule-comments@sec.gov. Please include SR-CHX-2004-20 on the subject line.

¹² For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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 SR-CHX-2004-20. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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 SR-CHX-2004-20 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.¹³

Margaret H. McFarland
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).