

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50904; File No. SR-BSE-2004-57)

December 21, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Boston Stock Exchange, Inc. Relating to the Execution Guarantee Rules

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 December 7, 2004, the Boston Stock Exchange, Inc. (“BSE” 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. The Commission is publishing this notice to solicit comments 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 amend its rules regarding execution guarantees. The text of the proposed rule change appears below.<sup>3</sup> Additions are in italics; deletions are in brackets.

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**RULES OF THE BOSTON STOCK EXCHANGE**

**Chapter II**

**Dealings on the Exchange**

**Sec. 33 Execution Guarantee**

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

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

<sup>3</sup> The Commission notes that a technical change was made to the proposed rule text of Sec. 33(a) submitted by the BSE to correct a typographical error. Specifically, in the rule text proposed to be added to this Section, the word "a" was changed to "at". Telephone conversation between John Boese, Vice President and Chief Regulatory Officer, BSE, and Jennifer Colihan, Special Counsel, Division of Market Regulation, Commission, on December 20, 2004.

(a) The Execution Guarantee shall be available to each member firm in all issues traded through the Intermarket Trading System (ITS) and registered to a specialist on the Exchange. Specialists must accept and guarantee execution on all agency market and marketable limit orders [from 100 up to and including 1,299 shares] on the basis of the NBBO bid on a sell order or the NBBO offer on a buy order at the time an order is received. Sell orders will be satisfied up to the size of the lesser of the NBBO bid or 1299 shares; buy orders up to the lesser of the NBBO offer or 1299 shares. No portion of an order larger than 1299 shares is subject to this public agency guarantee.

(b) Subject to the requirements of the short sale rule, all agency market orders must be filled on the basis of the Consolidated Quotation System best bid or better on a sell order, or the Consolidated Quotation System best offer or better on a buy order.

(c) All agency limit orders will be filled if one of the following conditions occur:

(1) the bid or offering at the limit price has been exhausted in the primary market as defined in the CTA Plan;

(2) there has been a price penetration of the limit in the primary market; or

(3) the issue is trading on the primary market at the limit price unless it can be demonstrated that such order would not have been executed if it had been transmitted to the primary market, or the broker and specialist agree to a specific volume-related or other criteria requiring a fill.

. . . Interpretations and Policies:

.01 Pre-opening orders must be accepted and filled at the primary market opening[, provided however that on such orders the specialist shall be obligated to accept orders up to 1299 shares on both the buy side and the sell side].

.02 In trading halt situations occurring on the primary market, orders will be executed based on

the reopening price.

.03 Simultaneous orders must be executed pursuant to the provisions of the Rule up to an accumulated size equal to the prevailing NBBO displayed size on receipt of the order.

.04 For purposes of limit order execution, size will be governed by that displayed on the Consolidated Quotation System ("CQS").

.05 If the displayed quotations of the Consolidated Quotation System can be demonstrated to be in error or a market center is experiencing system problems which result in an invalid quotation in CQS, an adjustment in execution price may be allowed as prescribed in .06.

.06 In unusual trading situations or in the event of an equipment failure, a specialist or floor broker may seek relief from the requirements of this rule from two out of three Floor Officials (floor members of the Market Performance Committee or Board of Governors).

## **Chapter XXXIII**

### **BEACON**

#### **Section 5 Automatic Execution Parameters**

[a) All market and marketable limit orders in ITS issues up to and including 1,299 shares will be eligible for automatic execution. All automatic execution parameters will be updated on a regular basis and published in BEACON. Specialists may provide larger automatic execution parameters than the 1299 minimum requirement. Parameters in excess of these minimum requirements will be pursuant to specific authorization by a Specialist with a member organization, and will not be published in BEACON.

(b) A 599 automatic execution parameter may be requested for a particular stock for good cause shown by submitting a statement to the Market Performance Committee setting forth the specific conditions and/or reasons that render participation at the 1299 parameter injurious.

(c) The BEACON reference price for automatic execution is the consolidated best bid or offer ("BBO") price. All market and marketable limit orders will be filled in their entirety (up to the current automatic execution parameter) at the reference price, regardless of the displayed size of the BBO.

(d) Market orders that would be executed outside the primary market price range for the day should be "stopped" and will be executed at the BEACON reference price, or better as subsequent trades occur on the Consolidated Tape.]

Automatic execution size parameters will be set in BEACON according to specialist specifications, by issue. All market or marketable limit orders of a size equal to or less than the automatic execution parameters will be automatically executed in their entirety, at the price of the NBBO.

Orders that are larger than the size of the automatic execution parameters, will be automatically executed up to the size of the automatic execution parameter, at the price of the NBBO. The remainder of any order which is not automatically executed, i.e. that portion of the order which is greater than the size of the automatic execution parameter, will be guaranteed professional handling by the specialist according to the specialist's fiduciary duties of best execution.

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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 BSE 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 two sections of the Rules of the Board of Governors of the Boston Stock Exchange (“BSE Rules”) relating to the guaranteed execution of agency market and marketable limit orders (“Execution Guarantee”).

In Chapter II, the Exchange sets forth rules related to the Execution Guarantee (“Execution Guarantee Rules”). Currently, the Execution Guarantee is that Exchange specialists must accept and guarantee execution of all agency market and marketable limit orders from 100 up to and including 1,299 shares, at the price of the National Best Bid or Offer (“NBBO”). The Exchange is proposing to amend its Execution Guarantee Rules so that specialists would be obligated to fill agency market and marketable limit orders at the price of the NBBO, but at a size of the lesser of the displayed size of the NBBO or 1,299 shares. The Exchange represents that the proposed rule change would be consistent with the rules of other exchanges in this area, specifically the Chicago Stock Exchange (Article XX, Rule 37) and the National Stock Exchange (Rule 11.9 (n)).

Although the BSE’s proposal is to limit the size of the Execution Guarantee, specialists would still be obligated, under the general principles of best execution, to seek the best execution of their customer orders. This would include the execution of a market order at the size available in the NBBO quotation. For example, if a specialist received a 5,000 share market order and the size reflected in the NBBO was 5,000 shares or greater, the specialist would be obligated to

pursue an execution of that order in its entirety, regardless of the BSE's Execution Guarantee Rules.<sup>4</sup>

The Exchange also notes that the average trade size executed on the primary listed markets has drastically reduced in recent years, due to a variety of factors. With the reduction of executed trade size, the size of the NBBO has also greatly reduced, thereby often making it difficult for BSE specialists to find a contra market for trades which they, under current rules, must execute at the NBBO price, for a size up to 1,299 shares, regardless of the size of the posted NBBO. In an era in which average quotation spreads are reducing to the lowest possible difference, the current BSE Execution Guarantee Rules in Chapter II often mean that BSE specialists are forced to absorb a position for which a market no longer exists. Accordingly, the Exchange is seeking to change its Execution Guarantee Rules so that its specialists are not disadvantaged by the requirements of this Rule.

The Exchange is also seeking to change its rules in Chapter XXXIII, BEACON, Section 5, Automatic Execution Parameters, regarding Automatic Execution Parameters ("Automatic Execution Rules"), so that the Automatic Execution Rules do not conflict with the proposed changes to the Execution Guarantee Rules. Currently, the Automatic Execution Rules discuss automatic execution parameters in relation to the 1,299 share requirement, and state that all market and marketable limit orders up to and including 1,299 shares will be eligible for automatic execution. The Automatic Execution Rules also discuss the updating and publishing of automatic execution parameters, and permit a specialist to provide automatic execution parameters in excess of the 1,299 share minimum guarantee. Further, they discuss the concept of

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<sup>4</sup> If the quote of the BSE specialist is the NBBO, the BSE specialist is obligated by Rule 11Ac1-1(c)(2) under the Act ("Quote Rule") to execute any order up to the size of his quote. 17 CFR 240.11Ac1-1(c)(2).

reference price, defined as the NBBO price, and state that all market and marketable limit orders will be filled in their entirety up to the size of the automatic execution parameter at the reference price, regardless of the size of the NBBO.

To be consistent with the changes proposed to the Execution Guarantee Rules, the Exchange is proposing to replace the current language in Chapter XXXIII, Section 5, in its entirety. The current language of this Section is closely related to the current Execution Guarantee Rules, such as the references to 1,299 share as being the minimum size of the automatic execution parameter. Also, the Exchange believes that the discussion of “reference price,” in particular the fact that it is essentially an undefined term within the BSE Rules, could lead to confusion with the proposed changes to the Execution Guarantee Rules discussed above. Therefore, the Exchange is proposing replacing the current language of Chapter XXXIII, Section 5 with language that more accurately reflects the automatic execution of orders on the BSE, in congruence with the proposed changes to the Exchange’s Execution Guarantee Rules.

The proposed new language of the Automatic Execution Rules explains that automatic execution parameters are set according to specialist specifications. All market or marketable limit orders of a size equal to or less than the automatic execution parameters will be automatically executed in their entirety at the price of the NBBO. For orders that are larger than the size of the automatic execution parameters, that portion of the order which is in excess of the execution parameter will be guaranteed handling by the specialist in accordance with the specialist’s fiduciary duties of best execution, although not necessarily automatic execution, while that portion of the order which would fall within the size of the automatic execution parameter will be automatically executed in BEACON.

## 2. Statutory Basis

The Exchange believes that the proposal is consistent with the requirements of Section 6(b) of the Act<sup>5</sup> in general, and Section 6(b)(5) of the Act,<sup>6</sup> 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 is not designed to permit unfair discrimination between customers, brokers, or dealers, or to regulate by virtue of any authority matters not related to the administration of the Exchange.

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

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

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

The Exchange has neither solicited nor received comments on the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Exchange has designated the proposed rule change as a non-controversial rule change pursuant to Section 19(b)(3)(A) of the Act<sup>7</sup> and Rule 19b-4(f)(6)<sup>8</sup> thereunder. Consequently, because the proposed rule change: (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 of filing,<sup>9</sup> or such shorter time as the Commission

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

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> 15 U.S.C. 78s(b)(3)(a).

<sup>8</sup> 17 CFR 240.19b-4(f)(6).

<sup>9</sup> The Commission has waived the requirement that the Exchange provide written notice of its intent to file the proposed rule change at least five days prior to the filing date in connection with this filing.

may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4 thereunder.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such 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](mailto:rule-comments@sec.gov). Please include File Number SR-BSE-2004-57 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 Number SR-BSE-2004-57. 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. Copies of such filing also will be available for inspection and copying at the principal offices of the BSE. 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 Number SR-BSE-2004-57 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.<sup>10</sup>

Margaret H. McFarland  
Deputy Secretary

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