

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-49530; File No. SR-CHX-2003-21)**

**April 6, 2004**

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Chicago Stock Exchange, Inc., Relating to the Price Improvement of Orders Executed Automatically on the Exchange**

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 July 17, 2003, the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CHX. The CHX filed Amendment No. 1 to the proposal on March 30, 2004.<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 CHX proposes to amend CHX Article XX, Rule 37, to revise its rules governing price improvement for orders executed automatically by the CHX’s MAX® execution system. The text of the proposed rule change appears below. Additions are italicized; deletions are bracketed.<sup>4</sup>

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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> Amendment No. 1 replaces the original filing in its entirety. See letter from Kathleen M. Boege, Vice President and Associate General Counsel, CHX, to Nancy J. Sanow, Division of Market Regulation (“Division”), Commission, dated March 29, 2004.

<sup>4</sup> With the CHX’s consent, the Commission made minor technical changes to indicate language being added to the text of the proposed rule. Telephone conversation between Kathleen M. Boege, Vice President and Associate General Counsel, CHX, and Yvonne Fraticelli, Special Counsel, Division, Commission, on March 31, 2004.

**ARTICLE XX**

**Regular Trading Sessions**

\* \* \* \* \*

**Guaranteed Execution System**

**and**

**Midwest Automated Execution System**

Rule 37.

\* \* \* \* \*

(d) Super MAX [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 elect, on a security-by-security basis, to enable the SuperMAX program, which will provide automated price improvement to orders automatically executed within the MAX System[ choose to enable this voluntary program within the MAX System on a security-by-security basis].

(1) Pricing

[(a) In the event that an order to buy or sell at least 100 shares is received in a security in which SuperMAX 2000 has been enabled, such order shall be executed at the ITS Best Offer or NBO (for a buy order) or the ITS Best Bid or NBB (for a sell order) if the spread between the ITS Best Bid and the ITS Best Offer (or NBB and NBO, for Nasdaq/NM issues) in such security at the time the order is received is less than \$.02.

(b) In the event that an order to buy or sell 100 shares is received in a security in which SuperMAX 2000 has been enabled, and the spread between the ITS Best Bid and the ITS Best Offer (or NBB and NBO, for Nasdaq/NM issues) in such security at the time the order is

received is \$.02 or greater, such order shall be executed (subject to the short sale rule) at a price at least \$.01 lower than the ITS Best Offer or NBO (for a buy order) or at least \$.01 higher than the ITS Best Bid or NBB (for a sell order).

(c) In the event that an order to buy or sell 100 shares or more [more than 100 shares] is received in a security in which SuperMAX [2000] has been enabled, such order shall be executed (subject to the short sale rule) at the ITS Best Offer (or NBO for Nasdaq/NM securities), or better (for a buy order) or the ITS Best Bid (or NBB for Nasdaq/NM securities), or better (for a sell order) as the specialist may designate and as is approved by the Exchange.

[(d) Odd Lot Market Orders. In the event that a market order to buy or sell less than 100 shares (or a market order otherwise deemed an odd lot by the Exchange) is received in a security in which SuperMAX 2000 has been enabled, and the spread between the ITS Best Bid and the ITS Best offer (or NBB and NBO, for Nasdaq/NM issues) in such security at the time the order is received is (A) less than \$.05, such order shall be executed at the ITS Best Offer or NBO (for a buy order) or the ITS Best Bid or NBB (for a sell order); or (B) \$.05 or greater, such order shall be executed at a price at least \$.01 lower than the ITS Best Offer or NBO (for a buy order) or at least \$.01 higher than the ITS Best Bid or NBB (for a sell order)].

(2) Operating Time. SuperMAX [2000] will operate each day that the Exchange is open for trading from the commencement of the Primary Trading Session until the close of the Primary Trading Session; provided, however, that preopening orders shall not be eligible for SuperMAX [2000] price improvement. A specialist may enable or remove SuperMAX [2000] for a particular security only on one given day each month, as determined by the Exchange from time to time. Notwithstanding the previous sentence, during unusual market conditions, individual securities or all securities may be

removed from SuperMAX [2000] with approval of two members of the Committee on Floor Procedure.

(3) Timing. Orders entered into SuperMAX [2000] shall be immediately executed upon completion of the [foregoing] price improvement algorithm without any delay (i.e., in 0 seconds).

(4) Applicability to Odd Lots Generated by OLES. Although an order generated by the Odd-Lot Execution Service (“OLES”) is a professional order (because it is deemed to be for the account of a broker-dealer), it is nonetheless eligible for SuperMAX [2000] execution if (i) the order is for 100 to 199 shares and (ii) the order is an OLES passively-driven system-generated market order (and not an actively managed order).

(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.

(6) Other. Any eligible order in a security for which SuperMAX [2000] has been enabled which is manually presented at the post by a floor broker must also be guaranteed an execution by the specialist pursuant to the pricing criteria set forth in paragraph (1) above. If the contra side order which would better a SuperMAX [2000] execution is presented at the post, the incoming order which is executed pursuant to the SuperMAX [2000] criteria must be adjusted to the better price.

## **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 on the

proposed rule change. 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 CHX proposes to amend CHX Article XX, Rule 37, which governs the price improvement of orders executed automatically on the CHX. Specifically, as described more fully below, the CHX seeks to amend CHX Article XX, Rule 37 to (i) delete rule provisions mandating different treatment for orders of 100 shares or less; and (ii) update the name of the automated price improvement program described in the rule from "SuperMAX 2000" to "SuperMAX."

SuperMAX 2000 is a voluntary CHX program under which CHX specialists may elect to provide price improvement of orders that are executed automatically by the CHX's MAX® execution system. Specialists may engage SuperMAX 2000 on an issue-by-issue basis.<sup>5</sup> Currently, under the SuperMAX 2000 rules, orders of 100 shares receive automatic price improvement of \$.01 or better when the BBO spread is \$.02 or greater. Larger orders may receive automatic price improvement of \$.01 or better.<sup>6</sup>

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<sup>5</sup> According to the CHX, all CHX specialist firms rely on the SuperMAX 2000 price improvement program to provide customers with execution prices that are superior to the national best bid or offer. The CHX estimates that SuperMAX 2000 is enabled for over 90% of the issues traded on the CHX.

<sup>6</sup> Price improvement of larger orders is effected by the SuperMAX 2000 system in accordance with algorithms designated by each CHX specialist on an issue-by-issue basis. The CHX specialist has the discretion to set price improvement algorithms to provide varying levels of price improvement for each issue, based on factors including order size, the bid/offer spread at the time the order was received, and other objective market factors. The CHX specialist may not use SuperMAX 2000 to provide for different price improvement outcomes based on the identity of the order sending firm.

When it was adopted in 2000,<sup>7</sup> SuperMAX 2000 represented the Exchange's efforts to combine five different price improvement programs that formerly were contained in the CHX rules. Each of these programs was based on factors including order size and BBO spread. The CHX hoped that SuperMAX 2000, as a distillation of the essential attributes of the five price improvement programs that preceded it, would eliminate the confusion that often resulted from the formerly labyrinthine CHX price improvement rules. Largely for marketing reasons, and to avoid concerns that SuperMAX 2000 represented too significant of a departure from the previous price improvement structure, SuperMAX 2000 contained separate provisions for price improvement of 100-share orders to establish a minimum threshold of price improvement for small orders.

At this juncture, several years after the adoption of the SuperMAX 2000 rules, the CHX believes that separate treatment of 100-share orders is no longer warranted. Indeed, the CHX believes that the elimination of any special treatment in the rules for 100-share orders may operate to reduce confusion, to the benefit of order-sending firms and the investing public. The CHX believes that it is appropriate for the CHX specialist to exercise the same discretion with respect to 100-share orders that he currently exercises with respect to larger orders in determining the level of price improvement that he is willing to provide for each issue.<sup>8</sup> Although this discretion would permit a CHX specialist to give a 100-share order a worse execution price than would be due under the current version of the rule, the Exchange does not believe that the proposed rule change would result in widespread specialist refusal to price

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<sup>7</sup> See Securities Exchange Act Release No. 43742 (December 19, 2000), 65 FR 83119 (December 29, 2000) (order approving File No. SR-CHX-00-37).

<sup>8</sup> The CHX specialist's discretion is limited by the CHX Article XX, Rule 37(d)(2), which prohibits changing SuperMAX 2000 price improvement parameters more than once per month.

improve 100-share orders.<sup>9</sup> Moreover, even if a number of CHX specialists do decline to price improve 100-share orders, the Exchange's rules still obligate CHX specialists to execute such orders at a price no worse than the national best bid or offer.

The proposed rule change also would delete CHX Article XX, Rule 37(d)(1)(d), the rule provision that deals specifically with price improvement of odd lot orders. In lieu of the deleted provision, CHX Article XXXI governs execution prices due odd lot orders.

## 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, and, in particular, with the requirements of Section 6(b).<sup>10</sup> The CHX believes the proposal is consistent with Section 6(b)(5) of the Act<sup>11</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments to, 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 CHX 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 on the Proposed Rule Change Received from Members, Participants, or Others**

No written comments were solicited or received.

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<sup>9</sup> In this regard, the CHX believes that specialist business considerations, including competitive forces in the securities markets, may dictate that CHX specialists continue to price improve most 100-share orders.

<sup>10</sup> 15 U.S.C. 78(f)(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

### **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 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. 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-2003-21. The 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 at 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 File No. SR-CHX-2003-21 and should be submitted by [insert date 21 days after the date of this publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Margaret H. McFarland  
Deputy Secretary

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