

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49567; File No. SR-CHX-2004-12)

April 15, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Inc. Relating to the Implementation of a Fully-Automated Functionality for the Handling of Particular Orders Called CHXpress

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 20, 2004, the Chicago Stock Exchange, Inc. (“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 April 8, 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 CHX proposes to amend CHX Article XX, Rule 37 to implement a new automated functionality for handling particular orders, called CHXpress. Below is the text of the proposed rule change.<sup>4</sup> Proposed new language is in italics.

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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> See letter from Ellen J. Neely, Senior Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated April 7, 2004, and the attached Form 19b-4, which replaced the original filing in its entirety (“Amendment No. 1”).

<sup>4</sup> With the Exchange’s consent, the Commission has made technical corrections to the text of the proposed rule change, which the Exchange has committed to correct formally by filing an amendment. Telephone conversation between Ellen J. Neely, Senior Vice President and General Counsel, CHX, and David Hsu, Attorney, Division, Commission, on April 15, 2004.

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ARTICLE XX

Regular Trading Sessions

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Guaranteed Execution System

and Midwest Automated Execution System

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Rule 37.

(a) Guaranteed Executions. The Exchange's Guaranteed Execution System (the BEST System) shall be available, during the Primary Trading Session and the Post Primary Trading Session, to Exchange member firms and, where applicable, to members of a participating exchange who send orders to the Floor through a linkage pursuant to Rule 39 of this Article, in all issues in the specialist system which are traded in the Dual Trading System and Nasdaq/NM Securities. System orders shall be executed pursuant to the following requirements, subject to section (b)(11) of this Rule 37:

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(b) Automated Executions. The Exchange's Midwest Automated Execution System (the MAX System) may be used to provide an automated delivery and execution facility for orders that are eligible for execution under the Exchange's BEST Rule (Article XX, Rule 37(a)) and certain other orders. In the event that an order that is subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the BEST Rule and the following. In the event that an order that is not subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the following:

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(8) All orders sent through MAX shall include the appropriate account type designator. The following are acceptable account types:

“P” – Principal/Professional Order	“D” - Program Trade, index arbitrage for Member/Member Organization
“A” – Agency	“C” – Program Trade, non-index arbitrage for Member/Member Organization
“I” – Individual Investor	“K” – Program Trade, index arbitrage for other agency
“J” – Program Trade, index arbitrage for Individual Customer	“Y” – Program Trade, non-index arbitrage for other agency
“U” – Program Trade, non-index arbitrage for Individual Customer	“Z” – Professional Order – Automatic Execution
“E” – <u>CHXpress Order</u>	

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(11) CHXpress Orders. This section applies to the execution and display of orders through CHXpress, an automated functionality offered by the Exchange. All other rules of the Exchange are applicable, unless expressly superseded by this section.

(A) Only an unconditional round lot limit order is eligible for entry as a CHXpress order. A CHXpress order may not be entered until an order has been executed on the primary market in the subject issue. A CHXpress order is good

only for the day on which it is submitted and will be automatically cancelled at the end of each day's trading session.

(B) A CHX specialist may not place a CHXpress order on hold or otherwise prevent an order-sending firm from cancelling the order. A CHX specialist may not cancel a CHXpress order.

(C) A CHXpress order to buy will be executed immediately against same or better-priced sell order(s) represented in the CHX specialist's book (or against the specialist), and a CHXpress order to sell will be executed immediately against same or better-priced buy order(s) represented in the CHX specialist's book (or against the specialist), unless:

- i. the execution would trade through another ITS market; or
- ii. trading in the subject issue has been halted.

If the execution of an inbound CHXpress order would cause an improper trade-through of another ITS market, the CHXpress order will be automatically cancelled.

(D) If a CHXpress order cannot be immediately executed, it will be placed in the specialist's book for display or later execution, in accordance with CHX rules. A CHXpress order will be instantaneously displayed, when it constitutes the best bid or offer in the CHX book. A CHXpress order, however, will not be displayed, if its display would improperly lock or cross another ITS market. If the display of an inbound CHXpress order would improperly lock or cross another ITS market, the CHXpress order will be automatically cancelled.

(E) CHXpress orders will not be eligible for SuperMAX automated price improvement, which is governed by Article XX, Rule 37(d).

(F) CHXpress orders will not be eligible for execution based on quotes in the national market system or activity in the primary market, as otherwise provided in Article XX, Rule 37(a)(2) and (3). As a result, an order eligible for execution based on quotes or trading activity in other markets may be filled even though a CHXpress order having a higher priority in the book is not filled.

(G) CHX specialists must integrate their handling of CHXpress orders with any manual executions that occur at the post by honoring manual trades that have been agreed upon, but not have yet been entered into the Exchange's systems.

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(d) SuperMAX 2000

SuperMAX 2000 shall be a voluntary automatic execution program within the MAX System. Subject to section (b) (11) of this Rule 37, 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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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. 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 Exchange proposes to implement a new automated functionality called CHXpress for certain orders. The Exchange represents that the CHXpress functionality, built into the Exchange's MAX® system, is designed to provide additional opportunities for the Exchange's members and their customers to seek and receive liquidity through automated executions of orders at the Exchange.<sup>5</sup>

**Eligible orders.** Under the proposed rules, only unconditional, round-lot limit orders could be designated as CHXpress orders.<sup>6</sup> CHXpress orders could be submitted in an issue only after an order has been executed on the primary market in that issue and would be automatically cancelled at the end of each trading day, if they remain unexecuted.<sup>7</sup>

**Execution of CHXpress orders.** CHXpress orders could be routed into the MAX system by the Exchange's order-sending firms or by CHX floor brokers. All orders would be required to be specifically designated as CHXpress orders to ensure appropriate handling in the Exchange's automated systems.<sup>8</sup>

CHXpress orders would be executed immediately and automatically against same or better-priced orders in the specialist's book, or against the specialist, unless those executions would trade through another Intermarket Trading System ("ITS") market or unless trading in the

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<sup>5</sup> The MAX system provides automated display and execution for orders sent to the Exchange's specialists for execution.

<sup>6</sup> See CHX Article XX, Rule 37(b), proposed section 11(A).

<sup>7</sup> Id. See also CHX Article XX, Rule 37(b), proposed section 11(B).

<sup>8</sup> See proposed addition to CHX Article XX, Rule 37(b)(8).

issue has been halted.<sup>9</sup> If a CHXpress order could not be immediately executed, it would be placed in the specialist's book for instantaneous display or later execution.<sup>10</sup> CHXpress orders, like all other orders at the Exchange, would not be eligible for automated display if that display would improperly lock or cross another ITS market.<sup>11</sup> CHX specialists would be required to integrate their handling of these orders with any executions that occur at the post with floor brokers or market makers.<sup>12</sup>

**Execution guarantees provided to CHXpress orders.** Under the proposed rules, CHXpress orders primarily are designed to match against orders in the specialist's book.<sup>13</sup> As a result, CHX specialists would not provide CHXpress orders with the execution guarantees that might otherwise be available to agency limit orders.<sup>14</sup> Specifically, these orders would not be eligible for automated price improvement, or execution based on quotes in the national market

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<sup>9</sup> If the execution of a CHXpress order would cause an improper trade-through of another ITS market, the CHXpress order would be automatically cancelled. See CHX Article XX, Rule 37(b), proposed section (11)(C). The Exchange would handle trading halts in CHXpress orders just as it does for all other types of orders in securities traded on the Exchange.

<sup>10</sup> A CHXpress order would be instantaneously and automatically displayed when it constitutes the best bid or offer in the CHX book. See CHX Article XX, Rule 37(b), proposed section 11(D).

<sup>11</sup> The Exchange's MAX system does not permit the automatic display of any order greater than 100 shares where that order would lock or cross another ITS market.

<sup>12</sup> For example, if the specialist is in the process of manually executing a floor broker order at the displayed bid, but a CHXpress order automatically executes against that bid – before the specialist is able to complete the transaction with the floor broker order – the specialist would still be required to honor the trade with the floor broker order at the displayed bid price, even if that displayed interest is no longer available.

<sup>13</sup> A specialist could participate in filling a CHXpress order, but could not do so if that execution would cause the specialist to trade ahead of any other order in the book.

<sup>14</sup> See CHX Article XX, Rule 37(b), proposed sections 11(E) and (F).

system or prints in the primary market for a security.<sup>15</sup> CHX specialists also would not act as agent for the orders in other markets. The Exchange believes that CHXpress orders would be used by order-senders that want either immediate executions against available interest or instantaneous order display, but do not want their orders to be placed on hold while a specialist seeks liquidity in other markets nor require that a specialist provide order execution guarantees of the type otherwise available to agency orders.

The Exchange has designed the CHXpress functionality to permit specifically-designated orders to immediately access available liquidity at the Exchange. The Exchange believes that this functionality would provide an important new way for eligible orders to interact within the Exchange's systems and that it would protect investors and the public interest by providing fair, automatic execution of those orders.

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act<sup>16</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>17</sup> in particular, because 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

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<sup>15</sup> Under the Exchange's existing rules, a specialist can engage an automated functionality in the MAX system to provide price improvement to eligible agency orders and can use automated functionalities to provide agency orders with protection against trades in the primary market for both listed and Nasdaq/NM securities. See CHX Article XX, Rule 37(d)(describing the SuperMAX price improvement functionality) and Rule 37(a)(3)(setting out the limit order protections otherwise guaranteed to limit orders, such as protections against primary market trades at or through a limit order's price).

<sup>16</sup> 15 U.S.C. 78(f)(b).

<sup>17</sup> 15 U.S.C. 78f(b)(5).



The Exchange does not believe that the proposed rule change, as amended, will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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 written comments on the proposed rule change, as amended.

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 the 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 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-CHX-2004-12 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-CHX-2004-12. 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 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 Number SR-CHX-2004-12 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>18</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).