

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-49736; File No. SR-CHX-2003-21)**

**May 19, 2004**

**Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 by the Chicago Stock Exchange, Inc., Relating to the Price Improvement of Orders Executed Automatically on the Exchange**

**I. Introduction**

On July 17, 2003, the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”), 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> a proposed rule change to amend CHX Article XX, Rule 37, to revise the rules governing the CHX’s SuperMAX 2000 program. The CHX filed Amendment Nos. 1 and 2 to the proposal on March 30, 2004,<sup>3</sup> and May 18, 2004,<sup>4</sup> respectively.

The proposed rule change and Amendment No. 1 were published for comment in the Federal Register on April 12, 2004.<sup>5</sup> The Commission received no comments regarding the proposal. This order approves the proposed rule change, as amended. In addition, the Commission is publishing notice to solicit comments on and is simultaneously approving, on an accelerated basis, Amendment No. 2.

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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 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> See letter from Kathleen M. Boege, Vice President and Associate General Counsel, CHX, to Nancy J. Sanow, Division, Commission, dated May 18, 2004 (“Amendment No. 2”). Amendment No. 2 revises the proposal to: (1) indicate that an order must receive the national best bid, or better, or the national best offer, or better, at the time the order was received; and (2) clarify that the CHX is deleting CHX Article XX, Rule 37(d)(1)(d) because the CHX intends for CHX Article XXXI to govern the execution prices due odd-lot orders. In addition, Amendment No. 2 states that it replaces an earlier version of Amendment No. 2 that the CHX filed with the Commission on May 12, 2004.

<sup>5</sup> See Securities Exchange Act Release No. 49530 (April 6, 2004), 69 FR 19253.

## II. Description of the Proposal

The CHX proposes to amend CHX Article XX, Rule 37, to revise its rules governing the SuperMAX 2000 program. SuperMAX 2000 is a program within the CHX's MAX® execution system that uses a computerized algorithm to provide automated price improvement to orders executed automatically within the MAX system. SuperMAX 2000 is a voluntary price improvement program, and CHX specialists may elect to engage SuperMAX 2000 on an issue-by-issue basis.<sup>6</sup>

Currently, the CHX's rules provide that in securities for which SuperMAX 2000 has been enabled: (1) an order for at least 100 shares will 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 in the security at the time the order is received is less than \$.02; (2) an order for 100 shares will 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 the NBB (for a sell order) if the spread in the security at the time the order is received is \$.02 or more; and (3) an order for more than 100 shares will be executed at the ITS Best Offer or NBO, or better, (for a buy order) or the ITS Best Bid or NBB, or better, (for a sell order) as the specialist may designate and as is approved by the CHX.<sup>7</sup> Thus, for orders of more than 100 shares, CHX specialists may establish 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 is received, and other objective market factors.

The CHX proposes to revise SuperMAX 2000 to: (1) change the name of the program to "SuperMAX;" (2) provide that any order of 100 shares or more will receive the ITS Best Bid or

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<sup>6</sup> The CHX estimates that SuperMAX 2000 is enabled for over 90% of the issues traded on the CHX.

<sup>7</sup> See CHX Article XX, Rule 37(d)(1).

ITS Best Offer in effect at the time the order was received,<sup>8</sup> or better, or the NBB or NBO in effect at the time the order was received, or better, as the specialist may designate and as is approved by the CHX; and (3) delete CHX Article XX, Rule 37(d)(1)(d), which concerns odd-lot orders for which SuperMAX 2000 has been enabled.<sup>9</sup> In lieu of CHX Article XX, Rule 37(d)(1)(d), CHX Article XXXI, “Execution of Odd-Lot Orders during the Primary Market Trading,” will govern the execution prices due odd-lot orders.<sup>10</sup>

According to the CHX, SuperMAX 2000, which was adopted in 2000,<sup>11</sup> combined five different price improvement programs formerly contained in the CHX’s rules. Each of the programs was based on factors including order size and best bid or offer spread. Largely for marketing reasons, SuperMAX 2000 contained separate provisions for price improvement of 100-share orders to establish a minimum threshold of price improvement for small orders.

The CHX believes that separate treatment of 100-share orders is no longer warranted and that the elimination of special treatment for 100-share orders could reduce confusion. In addition, the CHX believes that it is appropriate for CHX specialists to exercise the same discretion with respect to 100-share orders that they currently exercise with respect to larger orders in determining the level of price improvement that they are willing to provide.<sup>12</sup> Although the revised rule would permit CHX specialists to give 100-share orders worse execution prices than would be due under the current rule, the Exchange does not believe that the proposal would

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<sup>8</sup> See Amendment No. 2, *supra* note 4.

<sup>9</sup> Under CHX Rule XX, Article 37(d)(1)(d), an odd-lot order in which SuperMAX 2000 is enabled will 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 in the security at the time the order is received is less than \$.05. If the spread is \$.05 or greater, the odd-lot order will 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).

<sup>10</sup> See Amendment No. 2, *supra* note 4.

<sup>11</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>12</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.

result in widespread specialist refusal to price improve 100-share orders.<sup>13</sup> Moreover, the CHX notes that even if a number of CHX specialists declined to price improve 100-share orders, the CHX's rules would continue to obligate CHX specialists to execute such orders at a price no worse than the national best bid or offer.

On May 18, 2004, the CHX filed Amendment No. 2 to the proposal. Amendment No. 2 modifies the proposal by: (1) revising the text of the proposed rule to indicate that an order will receive the national best bid or offer in effect at the time the order was received, or better; and (2) clarifying that the CHX is deleting CHX Article XX, Rule 37(d)(1)(d) because the Exchange intends for CHX Article XXXI to govern the execution prices due odd-lot orders.<sup>14</sup>

### **III. Discussion**

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>15</sup> and, in particular, with the requirements of Section 6(b)(5) of the Act,<sup>16</sup> which requires, among other things, that the rules of a national securities exchange be 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. As described more fully above, the proposal modifies the CHX's SuperMAX rules to eliminate the requirement that 100-share orders receive price improvement of at least \$.01 when the national best bid or offer spread at the time the order is received is at least \$.02. Under the revised SuperMAX rules, 100-share orders will receive the same treatment provided currently

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<sup>13</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>14</sup> See Amendment No. 2, *supra* note 4.

<sup>15</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>16</sup> 15 U.S.C. 78f(b)(5).

for orders of more than 100 shares. Thus, both 100-share orders and orders of more than 100 shares will receive the national best bid or offer in effect at the time the order was received, or a better price, as determined by the specialist and approved by the CHX. In addition, the proposal will delete the current SuperMAX provisions concerning odd-lot orders and make clear that CHX Rule XXXI will govern the execution prices due odd-lot orders.

The Commission believes that the proposal should provide CHX specialists with greater flexibility in determining the level of price improvement that they will provide for 100-share orders, as well as for orders of more than 100 shares. Although 100-share orders in securities for which SuperMAX has been enabled no longer will receive minimum price improvement of at least \$.01 when the national best bid or offer spread at the time the order is received is at least \$.02, as provided under the current rule, the CHX's rules will continue to require the CHX's specialists to execute 100-share orders at a price no worse than the national best bid or offer in effect at the time the order was received. In addition, CHX specialists may continue to offer price improvement for 100-share orders.

Notwithstanding the foregoing, the Commission cautions that the duty of best execution requires a broker-dealer to seek the most favorable terms reasonably available under the circumstances for a customer's transaction.<sup>17</sup> A broker-dealer's duty of best execution is not necessarily satisfied by routing orders to a market center that merely guarantees an execution at the national best bid or offer.<sup>18</sup> Various markets and market makers may provide opportunities for executions at prices superior to the national best bid and offer. The Commission believes that

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<sup>17</sup> See, e.g., Securities Exchange Act Release Nos. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) (adopting Exchange Act Rule 11Ac1-4 and amending Exchange Act Rule 11Ac1-1) ("Order Handling Rules Release") at Section III.C.2.

<sup>18</sup> See, e.g., Order Handling Rules Release at III.C.2. and Securities Exchange Act Release No. 42450 (February 23, 2000), 65 FR 10577 (February 28, 2000) (notice of filing of SR-NYSE-99-48 and Commission request for comment on issues relating to market fragmentation) at Section IV.A.3.c.

broker-dealers deciding where to route or execute small customer orders must carefully evaluate the extent to which this order flow would be afforded better terms if executed in a market or with a market maker offering price improvement opportunities. In conducting the requisite evaluation of its internal order handling procedures, a broker-dealer must regularly and rigorously examine execution quality likely to be obtained from the different markets or market makers trading a security.<sup>19</sup>

With respect to odd-lots, because the CHX intends for CHX Article XXXI to govern the execution of odd-lot orders,<sup>20</sup> the Commission believes that deleting CHX Rule Article XX, Rule 37(d)(1)(d), will clarify the CHX's rules and eliminate potential confusion concerning the execution prices due to odd-lot orders.

The Commission finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Amendment No. 2 clarifies the proposal by indicating that an order must receive the national best bid or offer in effect at the time the order was received, and by stating that the CHX intends for CHX Article XXXI to govern the execution prices due odd-lot orders. Accordingly, the Commission finds that it is consistent with Sections 6(b)(5) and 19(b) of the Act to approve Amendment No. 2 on an accelerated basis.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

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<sup>19</sup> See Order Handling Rule Release, supra note 17 at Section III.C.2.

<sup>20</sup> See Amendment No. 2, supra note 4.

- 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-2003-21 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-2003-21. 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-2003-21 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

**V. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change (SR-CHX-2003-21), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</sup> 17 CFR 200.30-3(a)(12).