

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49978; File No. SR-CHX-2004-14)

July 7, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Relating to the Handling of Preopening Orders in Nasdaq/NM Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 19, 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, 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 CHX proposes to amend CHX Article XX, Rule 37, regarding the execution of preopening orders in Nasdaq/NM securities. The text of the proposed rule change is below. Proposed new language is in italics; proposed deletions are in brackets.

Guaranteed Execution System and Midwest Automated Execution System

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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] Nasdaq/NM Securities.

System orders shall be executed pursuant to the following requirements:

(1) No change to text.

(2) No change to text.

(3) No change to text.

(4) Preopenings. Preopening orders in Dual Trading System issues must be accepted and filled at the primary market opening trading price. In trading halt situations occurring in the primary market, orders will be executed based upon the reopening price. Preopening orders in [NASDAQ/NM] Nasdaq/NM securities must be accepted and filled on a single price opening at or better than the NBBO at the first unlocked, uncrossed market that occurs on or after 8:30 a.m., to the extent that those orders can be matched at a single price. The specialist will be responsible for executing any imbalance of shares in Nasdaq/NM securities left after the offset process, in accordance with Exchange rules that govern the handling of orders during the Primary Trading Session. In trading halt situations, orders will be executed based on the Exchange reopening price. For purposes of this rule, (a) preopening orders in Dual Trading System Issues are orders that are received before a primary market opens a subject security based on a print or based on a quote and (b) preopening orders in [NASDAQ/NM] Nasdaq/NM securities are orders received [at or]prior to the opening of the Exchange market [8:20 a.m. (Central Time)] on the date of the opening.

* * * * *

(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:

- (1) No change to text.
- (2) No change to text.
- (3) No change to text.
- (4) No change to text.

(5) Pre[-O]opening Orders. [Pre-Opening] Preopening orders [that are less than or equal to the auto-acceptance threshold] will automatically be offset by the MAX System at a single price at or better than the NBBO at the first unlocked, uncrossed market that occurs on or after 8:30 a.m., to the full extent that those orders can be matched at a single price. The [S]specialist will be responsible for executing [only be required to take a position when there is] any imbalance of shares left after the offset process, in accordance with Exchange rules that govern the handling of orders during the Primary Trading Session. [Pre-Opening orders will be filled at the price specified in the BEST Rule for Pre-Opening orders.]

* * * * *

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 its proposal 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 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

Under the Exchange's current rule, a CHX specialist must accept and execute all preopening orders in Nasdaq/NM securities on a single price opening at or better than the national best bid and offer ("NBBO") at the first unlocked, uncrossed market.³ A preopening order, for purposes of the rule, is an order received at or before 8:20 a.m. (Central Time) on the date of the opening. Under the current rule, the specialist is required to take a position when there is an imbalance of shares left after eligible orders are offset.⁴ Orders received after 8:20 a.m. and before 8:30 a.m. (Central Time) are not guaranteed a fill at any particular price.

The Exchange proposes to change the operation of this rule to remove the distinction in the treatment of orders received at or before 8:20 a.m. and those received after 8:20 a.m. (Central Time) until the opening of trading. Under the proposed rule change, all orders received before the opening would be treated in the same manner.

³ See CHX Article XX, Rule 37(a)(4). The NBBO is the price associated with the best bid and best offer disseminated pursuant to Rule 11Ac1-1 under the Act.

⁴ See CHX Article XX, Rule 37(b)(5).

Specifically, under this proposal, an Exchange specialist would match, to the extent possible, all orders received before the Exchange's opening at a single price that is at or between the NBBO at the first unlocked, uncrossed market that occurs on or after 8:30 a.m. (Central Time).⁵ The specialist would be responsible for executing any imbalance in shares left after the offset process, in accordance with Exchange rules that govern the handling of orders during the regular trading session.⁶ As a result, the specialist no longer would guarantee that orders received before 8:20 a.m. (Central Time) would receive a fill--orders that could be matched, would be matched--any order imbalance would remain for handling by the specialist.⁷

⁵ See proposed CHX Article XX, Rules 37(a)(4) and 37(b)(4).

⁶ These rules include the Exchange's rules relating to the execution of agency market, marketable limit and limit orders, as well as its rules relating to the precedence of orders in the CHX specialist's book. See CHX Article XX, Rules 37(a)(2) and 37(a)(3); CHX Article XXX, Rule 2.

⁷ As a technical matter, the Exchange's MAX system would identify the single opening price, based on the orders in the book and, to facilitate the execution of the maximum number of orders at that price, would insert the specialist into the execution of each order. For example, if there were two buy orders (for 120 shares and 150 shares) and two sell orders (for 100 shares and 170 shares) that could be matched at a single price at or between the NBBO, the system would match each order against the specialist, at the appropriate price, resulting in four execution reports, one for each order. The specialist does not profit through this practice. Any other handling of the matching process--for example, trying to match 100 shares of the first buy order against the 100-share sell order, and 150 shares of the second buy order against the second sell order, leaving 20 shares of the first buy order and 20 shares of the second sell order to execute against each other--results in additional, unwanted execution reports to the Exchange's order-sending firms. The Exchange would report only one side of these transactions (the side with the highest number of reportable shares, representing the best indication of the trades that actually occurred) to the tape to ensure that this practice does not have any potentially inappropriate impact on the Exchange's tape revenue.

The Exchange believes that this proposed rule change is appropriate because it simplifies the procedures for the handling and execution of preopening orders. It also allows a specialist to better fulfill its overall order handling responsibilities by eliminating any different treatment of orders received before and after 8:20 a.m. (Central Time).⁸

2. Statutory Basis

The Exchange believes that the proposed rule change 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).⁹ The CHX believes the proposal is consistent with Section 6(b)(5) of the Act¹⁰ 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.

⁸ Nothing in this proposed rule change, however, would prohibit a specialist, before the opening of the Exchange, from buying or selling in the over-the-counter market--for example, during Nasdaq's "trade or move" session--to position itself for the opening.

⁹ 15 U.S.C. 78(f)(b).

¹⁰ 15 U.S.C. 78(f)(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 CHX 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. Please include File Number SR-CHX-2004-14 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-2004-14. 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-2004-14 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.¹¹

Margaret H. McFarland
Deputy Secretary

¹¹ 17 CFR 200.30-3(a)(12).