

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52062; File No. SR-CHX-2004-03)

July 19, 2005

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Approving Proposed Rule Change Relating to Standards for Manual Execution of Market and Marketable Limit Orders

On February 11, 2004, the Chicago Stock Exchange, Incorporated (“CHX”), filed with the Securities and Exchange Commission (“Commission”), 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 Article XX, Rule 37 to eliminate a specific requirement that a specialist execute eligible orders at the price and size associated with the national best bid or offer (“NBBO”) and replace it with a requirement that specialists use reasonable diligence to ascertain the best available price for the security so that the resultant execution price is as favorable to the order sender as possible under prevailing market conditions. The new rule sets out factors that will be considered by the CHX in determining whether the specialist used reasonable diligence. On December 14, 2004, the CHX filed Amendment No. 1 to its original submission. The proposed rule change, as amended, was published for comment in the Federal Register on December 22, 2004.<sup>3</sup> The Commission received no comment letters with respect to the proposal.

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>4</sup> In particular, the Commission believes that the proposed rule

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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 Securities Exchange Act Release No. 50865 (December 16, 2004), 69 FR 76804.

<sup>4</sup> In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

change is consistent with Section 6(b)(5) of the Act,<sup>5</sup> which requires, among other things, that an exchange's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Specialists who execute market and marketable limit orders must, among other things, satisfy their duty of best execution by executing customer trades at the most favorable terms reasonably available under the circumstances. As amended, Article XX, Rule 37 will require specialists to use reasonable diligence to find the best available price for the security so that the resultant execution price is as favorable to the order sender as possible under prevailing market conditions. Furthermore, although CHX specialists no longer would be explicitly required to execute eligible orders at the NBBO, if the amended standard results in specialists effecting orders at a prices worse than the NBBO, this information would be reflected in the statistics that the CHX must produce pursuant to Rule 11Ac1-5.<sup>6</sup> Broker-dealers that route orders to the CHX would have to consider this information in connection with their duty to obtain best execution on behalf of their customers.

In addition, the Commission notes that the Exchange has committed to continue surveillance over order executions to ensure that specialists are using reasonable diligence to find the best available price for their customers. The Commission expects that such surveillance will be proactive and that meaningful disciplinary action will be taken against specialists found to have violated the rule.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national

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

<sup>6</sup> 17 CFR 240.11Ac1-5.

securities exchange, and, in particular, Section 6(b)(5) of the Act.<sup>7</sup>

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-CHX-2004-03) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

Jonathan G. Katz  
Secretary

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<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).