

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50620; File No. SR-CHX-2004-37]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Stock Exchange, Inc. Relating to the Trading of Nasdaq/NM Securities

November 2, 2004.

SUMMARY: Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice hereby is given that on October 29, 2004, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. 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 Exchange has requested a six-month extension of the pilot relating to the trading of Nasdaq/NM securities on the Exchange. Specifically, the pilot amended CHX Article XX, Rule 37 and CHX Article XX, Rule 43. The pilot currently is due to expire on November 1, 2004. The Exchange proposes that the pilot remain in effect on a pilot basis through May 1, 2005. The text of the proposed rule change is available at the principal offices of the CHX and at the Commission.

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 and discussed any comments it received regarding the proposed rule change. The text of these statements may be examined at the

places specified in Item IV below. 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 Exchange has requested a six-month extension of the pilot relating to the trading of Nasdaq/NM securities on the Exchange. Specifically, the pilot amends CHX Article XX, Rule 37 and CHX Article XX, Rule 43. The pilot currently is due to expire on November 1, 2004; the Exchange proposes that the amendments remain in effect on a pilot basis through May 1, 2005.

On May 4, 1987, the Commission approved certain Exchange rules and procedures relating to the trading of Nasdaq/NM securities on the Exchange.³ Among other things, these rules rendered the Exchange's BEST Rule guarantee (CHX Article XX, Rule 37(a)) applicable to Nasdaq/NM securities and made Nasdaq/NM securities eligible for the automatic execution feature of the Exchange's Midwest Automated Execution System (the "MAX" system).⁴

On January 3, 1997, the Commission approved, on a one year pilot basis, a program that eliminated the requirement that CHX specialists automatically execute orders for Nasdaq/NM securities when the specialist is not quoting at the national best bid or best offer disseminated pursuant to SEC Rule 11Ac1-1 (the "NBBO").⁵ When the Commission approved the program on a pilot basis, it requested that the Exchange submit a report to the Commission describing the Exchange's experience with the pilot program. The Commission stated that the report should include at least six

months of trading data. Due to programming issues, the pilot program was not implemented until April 1997. Six months of trading data did not become available until November 1997. As a result, the Exchange requested an additional three-month extension to collect the data and prepare the report for the Commission.

On December 31, 1997, the Commission extended the pilot program for an additional three months, until March 31, 1998, to give the Exchange additional time to prepare and submit the report and to give the Commission adequate time to review the report prior to approving the pilot on a permanent basis.⁶ The Exchange submitted the report to the Commission on January 30, 1998. Subsequently, the Exchange requested another three-month extension, in order to give the Commission adequate time to approve the pilot program on a permanent basis. On March 31, 1998, the Commission approved the pilot for an additional three-month period, until June 30, 1998.⁷ On July 1, 1998, the Commission approved the pilot for an additional six-month period, until December 31, 1998.⁸ On December 31, 1998, the Commission approved the pilot for an additional six-month period, until June 30, 1999.⁹ On June 30, 1999, the Commission approved the pilot for an additional seven-month period, until January 31, 2000.¹⁰ On January 31, 2000, the Commission approved the pilot for an additional three-month period, until May 1, 2000.¹¹ On May 1, 2000, the Commission approved the pilot for an additional six-month period, until November 1, 2000.¹² On November 15, 2000, the Commission approved the pilot for an additional one-year period, until November 1, 2001.¹³ On November 1, 2001, the pilot was extended for an additional one-year period, until November 1, 2002.¹⁴ On November 1, 2002, the pilot was extended for an

³ See Securities Exchange Act Release No. 24424 (May 4, 1987), 52 FR 17868 (May 12, 1987) (order approving File No. SR-MSE-87-2); see also Securities Exchange Act Release Nos. 28146 (June 26, 1990), 55 FR 27917 (July 6, 1990) (order expanding the number of eligible securities to 100); 36102 (August 14, 1995), 60 FR 43626 (August 22, 1995) (order expanding the number of eligible securities to 500); 41392 (May 12, 1999), 64 FR 27839 (May 21, 1999) (order expanding the number of eligible securities to 1000).

⁴ 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 and certain other orders. See CHX Rules, Art. XX, Rule 37(b). A MAX order that fits within the BEST parameters is executed pursuant to the BEST Rule via the MAX system. If an order is outside the BEST parameters, the BEST rule does not apply, but MAX system handling rules remain applicable.

⁵ See Securities Exchange Act Release No. 38119 (January 3, 1997), 62 FR 1788 (January 13, 1997).

⁶ See Securities Exchange Act Release No. 39512 (December 31, 1997), 63 FR 1517 (January 9, 1998).

⁷ See Securities Exchange Act Release No. 39823 (March 31, 1998), 63 FR 17246 (April 8, 1998).

⁸ See Securities Exchange Act Release No. 40150 (July 1, 1998), 63 FR 36983 (July 8, 1998).

⁹ See Securities Exchange Act Release No. 40868 (December 31, 1998), 64 FR 1845 (January 12, 1999).

¹⁰ See Securities Exchange Act Release No. 41586 (June 30, 1999), 64 FR 36938 (July 8, 1999).

¹¹ See Securities Exchange Act Release No. 42372 (January 31, 2000), 65 FR 6425 (February 9, 2000).

¹² See Securities Exchange Act Release No. 42740 (May 1, 2000) 65 FR 26649 (May 8, 2000).

¹³ See Securities Exchange Act Release No. 43565 (November 15, 2000), 65 FR 71166 (November 29, 2000).

¹⁴ See Securities Exchange Act Release No. 45010 (November 1, 2001), 66 FR 56585 (November 8, 2001).

¹⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

additional one-year period, until November 1, 2003.¹⁵ On November 1, 2003, the pilot was extended for an additional one-year period until November 1, 2004.¹⁶ In light of the evolving nature of the Nasdaq market and unlisted trading of Nasdaq/NM securities, the Exchange now requests another extension of the current pilot program, through May 1, 2005. The Exchange is not requesting approval of any changes to the pilot in this submission.

Under the pilot program, specialists must continue to accept agency market orders¹⁷ or marketable limit orders, but only for orders of 100 to 5099 shares in Nasdaq/NM securities. This threshold order acceptance requirement is referred to as the "auto acceptance threshold." Specialists, however, must accept all agency limit orders in Nasdaq/NM securities from 100 up to and including 10,000 shares for placement in the limit order book. Specialists are required to automatically execute Nasdaq/NM orders in accordance with certain amendments to the pilot program that were approved by the Commission.¹⁸

The pilot program has no minimum auto execution threshold for Nasdaq/NM securities. When a CHX specialist is quoting at the NBBO, orders for a number of shares less than or equal to the size of the specialist's quote are executed automatically (in an amount up to the size of the specialist's quote). Orders of a size greater than the specialist's quote are automatically executed up to the size of the specialist's quote, with the balance of the order designated as an open order in the specialist's book, to be filled in accordance with the Exchange's rules for manual execution of orders for Nasdaq/NM securities. Such rules dictate that the specialist must either manually execute the order at the NBBO or a better price or act as agent for the order in seeking to obtain the best available price for the order on a marketplace other than the Exchange. If the specialist decides to act as agent for

the order, the pilot program requires the specialist to use order-routing systems to obtain an execution where appropriate. Orders for securities quoted with a spread greater than the minimum variation are executed automatically after a fifteen second delay from the time the order is entered into MAX. The size of the specialist's bid or offer is then automatically decremented by the size of the execution. When the specialist's quote is exhausted, the system generates an autoquote at an increment away from the NBBO for 100 shares.

When the specialist is not quoting a Nasdaq/NM security at the NBBO, an order that is of a size less than or equal to the auto execution threshold designated by the specialist will execute automatically at the NBBO price up to the size of the auto execution threshold. Orders of a size greater than the auto execution threshold will be designated as open orders in the specialist's book and manually executed, unless the order-sending firm previously has advised the specialist that it elects partial automatic execution, in which event the order will be executed automatically up to the size of the auto execution threshold, with the balance of the order to be designated as an open order in the specialist's book.

Whether the specialist is quoting at the NBBO or not, "oversized" orders, *i.e.*, orders that are of a size greater than the auto acceptance threshold of 5099 shares (as designated by the specialist), are not subject to the foregoing requirements, and may be canceled within one minute of being entered into MAX or designated as an open order.

2. Statutory Basis

The CHX believes that the proposed rule is consistent with Section 6(b) of the Act,¹⁹ generally, and Section 6(b)(5) of the Act²⁰ in that it is designed to promote just and equitable principles of trade, to remove impediments 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.

C. Self-Regulatory Organization's Statement of Burden on Competition

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

D. Self-Regulatory Organization's Statement on Comments Regarding the Proposed Rule Change Received From Members, Participants or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act²¹ and subparagraph (f)(6) of Rule 19b-4²² thereunder because the proposal: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the Exchange has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the filing date of the proposed rule change. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate, in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

The Exchange has requested that the Commission waive the 5-day pre-filing notification requirement and the 30-day operative delay. The Commission believes that waiving the 5-day pre-filing notification requirement and the 30-day operative delay is consistent with the protection of investors and the public interest.²³ The Commission notes that waiver of the 5-day pre-filing requirement and acceleration of the operative date will prevent the Exchange's pilot program relating to the trade of Nasdaq/NM securities from lapsing, and will allow the current rules to remain effective.

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:

²¹ 15 U.S.C. 78s(b)(3)(A).

²² 17 CFR 240.19b-4.

²³ For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁵ See Securities Exchange Act Release No. 46932 (November 29, 2002), 67 FR 72990 (December 9, 2002).

¹⁶ See Securities Exchange Act Release No. 48742 (November 3, 2003), 68 FR 63829 (November 10, 2003).

¹⁷ The term "agency order" means an order for the account of a customer, but does not include professional orders, as defined in CHX Rules, Art. XXX, Rule 2, Interpretation and Policy .04. The rule defines a "professional order" as any order for the account of a broker-dealer, the account of an associated person of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest.

¹⁸ See Securities Exchange Act Release No. 44778 (September 7, 2001), 66 FR 48075 (September 17, 2001).

¹⁹ 15 U.S.C. 78f(b).

²⁰ 15 U.S.C. 78f(b)(5).

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-2004-37 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-2004-37. 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 offices 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-2004-37 and should be submitted on or before November 30, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁴

Jill M. Peterson,

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50619; File No. SR-CHX-2003-07]

**Self-Regulatory Organizations;
Chicago Stock Exchange, Inc.; Order
Granting Approval of Proposed Rule
Change and Amendments No. 1 and
No. 2 Thereto Relating to Out-of-Range
Execution Rules**

November 2, 2004.

On March 20, 2003, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² to amend CHX Article XX, Rule 37, which governs, among other things, "out-of-range" executions.³ The Exchange amended the proposal on March 10, 2004,⁴ and September 15, 2004.⁵ The proposed rule change, as amended, was published for comment in the **Federal Register** on September 29, 2004.⁶ The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

After careful review, the Commission finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁷ In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act⁸ 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ An "out-of-range" execution is an execution that would create a new high or new low for the day when compared to the primary market range.

⁴ See letter from Kathleen M. Boege, Vice President & Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 10, 2004 ("Amendment No. 1"). Amendment No. 1 clarified the purpose and effects of the proposal.

⁵ See letter from Kathleen M. Boege, Vice President & Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated September 13, 2004 ("Amendment No. 2"). Amendment No. 2 replaced the original proposal and Amendment No. 1 in their entirety.

⁶ See Securities Exchange Act Release No. 50417 (September 21, 2004), 69 FR 58208.

⁷ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f(b)(5).

general, to protect investors and the public interest.

CHX Article XX, Rule 37, governs the Exchange's Midwest Automated Execution ("MAX") system and its SuperMAX 2000 system. Currently, Rule 37 contains provisions stating that neither system shall automatically execute an order if the execution would set a new high or new low for the day compared to the primary market price. If an out-of-range execution would result, the order is deemed to have been submitted with a request for a stop and will be sent to a CHX specialist for manual handling. This proposal would eliminate these provisions, thereby allowing MAX and SuperMAX 2000 to effect automatic executions that may establish new highs or new lows for the day. CHX believes that these provisions are no longer necessary because, with the advent of decimal pricing and the increase in trading volume at regional exchanges such as CHX, an out-of-range execution is more readily seen by customers as reflecting the current market for the security.

The out-of-range provisions in Rule 37 were designed to assist specialists in providing customers primary market price protection and to provide those customers an opportunity for price improvement by offering a stop. Although the Commission found these provisions to be consistent with the Act,⁹ it does not believe that the Act compels CHX to offer this particular form of investor protection. Therefore, the Commission believes that it is consistent with the Act for CHX to delete these provisions, thereby allowing its automatic execution systems to establish new highs and new lows for a security.

Although deleting the provisions that treat orders that would result in out-of-range executions as if they had a request for a stop, certain of CHX's other rules contain references to the practice of stopping stock.¹⁰ CHX has represented that it is appropriate to clarify whether the practice of stopping stock should be permitted on the Exchange. If the Exchange's management, member committees, and Board of Governors determine that the practice of stopping stock on the Exchange should be prohibited, the Exchange would propose a separate rule change to the Commission. On the other hand, if the Exchange determines that it remains appropriate for CHX specialists to stop stock in certain limited circumstances, CHX has represented that it would

⁹ See Securities Exchange Act Release No. 36401 (October 20, 1995), 60 FR 54893 (October 26, 1995).

¹⁰ See CHX Article XX, Rules 28 and 37(b)(2).

²⁴ 17 CFR 200.30-3(a)(12).