

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

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*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47443; File No. SR-CHX-2002-40]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Inc. Relating to Zero-Second Display of Certain Limit Orders

March 4, 2003.

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> notice is hereby given that on December 26, 2002, 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 January 10, 2003, the exchange filed an amendment to 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.<sup>4</sup>

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Article XX, Regular Trading Sessions, CHX Rule 7, Recognized Quotations, and CHX Rule 37, Guaranteed Execution System and Midwest Automated

Execution System, which govern, among other things, display of limit orders in a specialist's book. The text of the proposed rule change is below. Proposed new language is in italics.

#### Chicago Stock Exchange Rules

##### Article XX Regular Trading Sessions

\* \* \* \* \*

#### Recognized Quotations

##### RULE 7

No change to text.

#### • • • Interpretations and Policies:

.01-.04 No change to text.

.05 (a) Quotation sizes, unless otherwise specified, shall be assumed to be for 100 shares. With respect to agency limit orders received by specialists, each specialist shall publish immediately (*i.e.*, as soon as practicable, which under normal circumstances means no later than 30 seconds from time of receipt, *subject to the provisions below relating to agency limit orders designated "post protection only"*) a bid or offer that reflects:

(i) The price and full size of each agency limit order that is at a price that would improve the specialist's bid or offer in such security; and  
(ii) The full size of each agency limit order that is priced equal to the specialist's bid or offer for such security.

(b) The requirements with respect to specialists' display of limit orders shall not apply to any limit order that is:

(i) Executed upon receipt of the order;  
(ii) Placed by a person or entity who expressly requests, either at the time the order is placed or prior thereto pursuant to an individually negotiated agreement with respect to such person's orders, that the order not be displayed;  
(iii) An odd-lot order;

(iv) Delivered immediately upon receipt to an exchange or association-sponsored system or an electronic communications network that complies with the requirements of Securities and Exchange Commission Rule 11Ac1-1(c)(5) under the Securities Exchange Act with respect to that order;

(v) Delivered immediately upon receipt to another exchange member or over-the-counter market maker that complies with the requirements of Securities and Exchange Commission Rule 11Ac1-4 under the Securities Exchange Act with respect to that order;

(vi) An all or none order; or

(vii) A block size order, unless the customer order is received with a request that the order be displayed.

*If a floor broker designates an agency limit order, in a manner specified by the Exchange, as "post protection only,"*

*and sends that order to the specialist via the MAX system, the specialist receiving such order shall display the limit order in zero seconds. Such order will not be entitled to primary market price protection or other protections due limit orders under Article XX, Rule 37(a)(3).*

\* \* \* \* \*

Guaranteed Execution System and Midwest Automated Execution System

\* \* \* \* \*

RULE 37(a). Guaranteed Executions.

\* \* \* \* \*

3. Dual Trading System Agency Limit Orders. Subject to Interpretation and Policy .10 ("Exempted Trade-Throughs"), all agency limit orders in Dual Trading System issues will be filled under the following circumstances:

(a) Exhaustion of primary market bid or offer. When the bid or offering at the limit price has been exhausted in the primary market (as defined in the CTA plan), agency limit orders will be executed in whole or in part, based on the rules of priority and precedence, on a share for share basis with trades executed at the limit price in the primary market;

(b) Price penetration in primary market. When there has been a price penetration of the limit in the primary market, agency limit orders that have resided in the specialist's book for a period of 0-15 seconds (as designated by the specialist) prior to the primary market print will be filled at the limit price;

(c) Primary market trading at the limit price. When the issue is trading at the limit price on the primary market, agency limit orders will be filled at the limit price unless it can be demonstrated that such orders would not have been executed if they had been transmitted to the primary market or the broker and specialist agree to a specific volume related or other criteria for requiring a fill; and

(d) Block size trade-through in another market. In instances where a block trade on the Exchange or other market against which orders are being protected takes place outside the current Exchange quotation, all effective bids or offers limited to the block price or better will be executed at the more favorable block price rather than at the limit price of the affected orders. A specialist may elect to provide automatic execution of designated limit orders at the block price or better when a "block size" (as defined in Article XX, Rule 40, Interpretation and Policy .05) trade-through is executed on the primary market.

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter, dated January 9, 2003, from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission ("Amendment No. 1"). In Amendment No. 1, the CHX provided additional clarity as to the full extent of limit order protection that would be forfeited by a floor broker that elects "post protection only" ("PPO") under the proposed rule change.

<sup>4</sup> The CHX requested that the Commission make various non-substantive typographical corrections to the notice in the rule language and purpose section. In addition, the CHX requested that the Commission add an additional protection related to block trades as described in footnote 7 below. Such protection was added due to an intervening CHX rule change that was not in place at the time of filing of the instant proposed rule change. Telephone conference between Kathleen M. Boege, Associate General Counsel, CHX, and Christopher B. Stone, Special Counsel, Division, Commission (March 3, 2003).

A specialist may elect automatic execution of such agency limit orders on an issue-by-issue basis. *The foregoing provisions of this Article XX, Rule 37(a)(3) shall not apply to limit orders designated by a floor broker as "post protection only" in accordance with the provisions of Article XX, Rule 7, Interpretation and Policy .05.*

## 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 on 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 amend Article XX, Rules 7 and 37 of the CHX Rules, which govern, among other things, display of limit orders in a specialist's book and execution prices due certain limit orders. The proposed change would permit a CHX member (including a floor broker) to elect zero-second display by a CHX specialist of limit orders designated by the member as PPO orders.

Under Exchange Act Rule 11Ac1-4<sup>5</sup> and current Article XX, Rule 7 (Interpretation and Policy .05) of the CHX Rules, a CHX specialist must display customer limit orders "immediately," which means " \* \* \* as soon as practicable, which under normal market conditions means no later than 30 seconds from time of receipt." Although past studies have shown that CHX specialists, through the use of automated tools, display the vast majority of customer limit orders within zero seconds after they are required to do so, CHX specialists may choose to actually see one or more orders before deciding whether or not to execute the order, transfer the order to another marketplace or display the order at the Exchange.<sup>6</sup>

In some cases, however, customers expressly desire the zero-second display of their orders. Specifically, the CHX has been advised that, for certain customers of CHX floor brokers, zero-second display of their limit orders is often their paramount consideration. While CHX specialists may choose not to display each limit order in zero seconds—because they may wish to have the opportunity to decide whether or not to interact with certain limit orders—the CHX floor broker community has suggested a solution which protects the interests of CHX member order-sending firms and their customers, while permitting CHX specialists to appropriately handle limit orders.

Under the proposed rule change, PPO orders (as designated by a CHX floor broker) would be automatically displayed by the specialist in zero seconds without any opportunity for a specialist to interact with the order prior to display. PPO orders would be treated in accordance with applicable CHX rules governing priority and precedence, but would not be entitled to trade through protection by the CHX specialist in the event of a price penetration in the primary market.<sup>7</sup> This solution will afford CHX floor brokers the flexibility to elect zero-second display of their customers' limit orders in instances that render such immediacy of paramount concern. The proposal in turn does not require a specialist to provide subject limit orders with trade through protection or the other protections set forth in Article XX, Rule 37(a)(3), when the specialist has been

provided in the CHX trading system. These default timers, which can be set, among other things, from zero to 25 seconds (in listed securities) or from zero to 30 seconds (in over-the-counter ("OTC") securities), ensure that eligible orders are automatically displayed when they improve a specialist's quote and when the timer setting has elapsed without the orders having been manually displayed, executed or transferred to another marketplace. In addition, the CHX Market Regulation Department actively surveils to ensure that CHX specialists do not routinely rely on their timers to extend the display period beyond what is necessary for the specialist to interact with the limit orders they receive.

<sup>7</sup> Under Article XX, Rule 37(a)(3), a limit order for a Dual Trading System (*i.e.*, listed) issue, which is resident in a CHX specialist's book for 15 seconds or more, generally is entitled to "trade through protection," *i.e.*, execution at the limit price in the event of a price penetration in the primary market. Article XX, Rule 37(a)(3) also requires execution at the limit price, subject to certain conditions, (a) if the bid or offer has been exhausted in the primary market, (b) if the issue is trading at the limit price in the primary market, and (c) if a block trade has been printed on the Exchange or an away market at superior price. A floor broker electing PPO would also forego these protections otherwise due under Article XX, Rule 37(a)(3).

denied the opportunity to interact with the order.

The CHX believes that the proposal is consistent with the interests of the investing public, as a floor broker will be able to elect zero-second display of a limit order when that display is either requested by the customer or otherwise is in a customer's interest.<sup>8</sup> In other instances, an order-sending firm may consider the protections of Article XX, Rule 37(a)(3) to constitute a better means of achieving its customer's goals, in which case the floor broker could elect to forego zero-second display.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of section 6(b) of the Act,<sup>9</sup> in general, and Section 6(b)(5) of the Act,<sup>10</sup> in particular, which requires, among other things, that the rules of an exchange be designed, among other things, 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 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.

## 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**

<sup>8</sup> Orders routed to a CHX floor broker constitute orders from sophisticated investors who choose to utilize the services of a floor broker because, among other reasons, the investor can communicate certain conditions regarding execution of the order, which conditions the floor broker will take into account in seeking liquidity to fill the order. Such investors possess sufficient market experience to fully evaluate the consequences of having their floor broker elect the PPO order option on their behalf. By restricting the PPO order option to floor brokers, the CHX believes that it will avoid instances where less sophisticated investors would elect zero-second display of their limit orders, without fully considering the ramifications of foregoing primary market protection of such limit orders.

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>5</sup> 17 CFR 240.11Ac1-4 ("Display Rule").

<sup>6</sup> Specialists can help ensure that they meet their Display Rule obligations with respect to these manually handled orders by using additional automated functions, such as the default timers

**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 such proposed rule change, as amended, or

(B) institute proceedings to determine whether the proposed rule change, as amended, 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, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, as amended, that are filed with the Commission, and all written communications relating to the proposed rule change, as amended, 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CHX-2002-40 and should be submitted by April 3, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

Margaret H. McFarland,

Deputy Secretary.

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47449; File No. SR-ISE-2003-08]

#### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the International Securities Exchange, Inc., Relating to Fee Changes

March 5, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

#### ISE SCHEDULE OF FEES

[Electronic Market Place]

Execution fees	Amount (\$)	Billable unit	Frequency	Notes
Customer .....	0.05	contract/side .....	Transaction .....	Fee waived through June 30, 2003.
Facilitation .....	0.15	contract/side .....	Transaction .....	
Market Maker & Firm Proprietary (including members of other exchanges executing Linkage transactions, except Satisfaction Orders).	.....	.....	.....	<i>For Complex Orders, charged only for the leg of the trade consisting of the most contracts; Firm Proprietary fees for trades executed in the Block Order Mechanism and for all trades in the iShares S&amp;P 100 Index Fund waived through May 31, 2003; fees for Complex Orders waived through June 30, 2003.</i>
A.D.V. Less Than 300,000 .....	0.21	contract/side .....	Transaction .....	Based on Exchange A.D.V.
A.D.V. From 300,001 to 500,000 ...	0.17	contract/side .....	Transaction .....	Based on Exchange A.D.V.
A.D.V. From 500,001 to 700,000 ...	0.14	contract/side .....	Transaction .....	Based on Exchange A.D.V.
A.D.V. Over 700,000 .....	0.12	contract/side .....	Transaction .....	Based on Exchange A.D.V.

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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 and discussed any comments it received on 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.

("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 26, 2003, the International Securities Exchange, Inc. ("Exchange" or "ISE") 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 ISE. 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 is proposing changes to its Schedule of Fees regarding complex orders. First, the Exchange proposes to charge its regular execution fees only on one leg of the complex order (as opposed to charging on each leg). Second, the Exchange proposes to waive all such execution fees for complex orders through June 30, 2003. Below is the text of the proposed rule change. Proposed new language is in *italics*.

\* \* \* \* \*

#### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

The Exchange is proposing changes to its Schedule of Fees regarding complex orders in an attempt to provide its members with an incentive to execute complex orders on the Exchange.

<sup>11</sup> 17 CFR 200.30-3(a)(12).

<sup>15</sup> U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.