

promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The CBOE does not believe that the proposed rule change will impose any burden on competition 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*

No written comments were solicited or received with respect to 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 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, 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, as amended, 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2004-43 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-CBOE-2004-43. 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 CBOE. 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-CBOE-2004-43 and should be submitted on or before August 9, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. 04-16326 Filed 7-16-04; 8:45 am]

**BILLING CODE 8010-01-P**

### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-50002; File No. SR-CHX-2004-11]

#### **Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Inc. Relating to the Implementation of a Fully-Automated Electronic Book for the Display and Execution of Orders in Securities That Are Not Assigned to a Specialist**

July 12, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 20, 2004, 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 June 18, 2004, the Exchange amended 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.

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

The CHX proposes to implement a fully-automated electronic book for the display and execution of orders in securities that are not assigned to a specialist. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

#### *Article XXA*

##### *Operation of Electronic Book*

*The electronic book is a fully-automated system operated by the Exchange, which allows eligible orders in eligible securities to match against one another.*

##### *Eligible Securities*

*Rule 1. All securities eligible for trading on the Exchange that are not assigned to a specialist shall be eligible for trading through the electronic book. Any specialist request to remove a security from the electronic book shall be considered by the Committee on Specialist Assignment and Evaluation.*

##### *Eligible Orders*

*Rule 2.(a) All orders sent to the electronic book must be round-lot limit orders, specifically designated in the manner specified by the Exchange to confirm that they are eligible for trading in the electronic book.*

*(b) Eligible orders additionally may be designated as one of the following order types:*

*(1) "Immediate or cancel": An order that is to be executed, either in whole or in part, as soon as the order is received by the electronic book, with any unexecuted balance of the order to be immediately cancelled.*

*(2) "Fill or Kill": an order that is to be executed in full as soon as the order is received by the electronic book, but that should be immediately cancelled if it is not executed.*

<sup>3</sup> See letter from Ellen J. Neely, Senior Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated June 17, 2004, and the attached Form 19b-4, which replaced the original filing in its entirety ("Amendment No. 1").

<sup>7</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.

(3) "Cross": An order to buy and sell the same security at a specific price equal to or better than the NBBO and better than the best bid and offer displayed in the electronic book. A cross order may represent interest of one or more members of the Exchange.

(4) "Cross with size": An order to buy and sell at least 25,000 shares of the same security (A) at a price equal to or better than both the NBBO and the best bid or offer displayed in the electronic book; (B) where the size of the order is larger than the aggregate size of all interest displayed in the electronic book at that price; and (C) where neither side of the order is for the account of the CHX member sending the order to the electronic book.

(c) Orders may be entered by a member on its own behalf (a proprietary or professional order) or for the account of a customer (an agency order). In the electronic book, however, agency orders are subject to the same display and execution processes as professional orders and agency orders do not receive any priority in order execution or handling.

(d) In listed securities, an order is not eligible for execution in the electronic book if it crosses or locks the NBBO at the time that it is received, unless the order locks or crosses the BBO in the electronic book. An order in a listed security that locks or crosses the NBBO at the time it is received shall be immediately cancelled. An order in a listed security that locks or crosses the BBO in the electronic book shall be executed against orders in the electronic book, as set out in Rule 4(c), below; any remaining portion of the order shall be automatically cancelled, if it would lock or cross the NBBO.

(e) All orders submitted to the electronic book are good for the day on which they are submitted only and shall be automatically cancelled at the end of each day's trading session.

#### Operating Hours

Rule 3.(a) The electronic book will operate during the Exchange's Primary and Post-Primary Trading Sessions, as further described below.

(b) The electronic book will accept orders each day once the primary market for a security opens its market on either a quote or a trade. For purposes of this rule, the primary market in a security is, unless otherwise designated by the Rules Subcommittee, the listing market for a security; provided, however, that if a security is traded by the NYSE, then the primary market for such security is the NYSE and if a security is traded by the Amex, then the primary market for such

security is the Amex. If a security is traded on both the NYSE and the Amex, whichever of the two is the listing market is the primary market. If a security is listed on both the NYSE and Nasdaq, the NYSE will be considered the primary market.

(c) The electronic book will close at 3:30 p.m. (Central Time).

(d) The electronic book will not operate during regulatory halts called by the primary or listing market in a security, in accordance with rules set out in the appropriate transaction reporting plans. Additionally, the electronic book will halt its operation during periods of market volatility following the rules in Article IX, Rule 10A.

#### Operation of the Electronic Book

Rule 4. (a) Routing of orders. Orders shall be routed to the electronic book using one of the following methods:

(1) Except for the orders described in paragraph (2) below, all orders must be sent to the electronic book through the Exchange's MAX system or through other communications lines approved by the Exchange for the delivery of orders by its members.

(2) ITS commitments for ITS-eligible securities traded in the electronic book shall be sent through the ITS system. NASD market participants shall have direct telephonic access to the supervisory center for the Exchange's electronic book to enter orders in the electronic book, for the securities in which those participants are registered with NASD as market makers or as electronic communications networks/alternative trading systems.

(b) Ranking and display of orders. All orders sent to the electronic book shall be ranked according to their price and time of receipt, as follows:

(1) Limit orders shall be ranked based on their limit prices and times of receipt by the electronic book.

(2) All orders shall be immediately and publicly displayed through the processes set out in the appropriate transaction reporting plan for each security when they constitute the best bid or offer in the electronic book for that security.

(c) Automated matching of orders. Orders shall automatically match against each other, as follows:

(1) Except for "cross with size" transactions, which shall be executed as described in Rule 2(b)(4), above, an incoming order shall be matched against one or more orders in the electronic book, in the order of their ranking, at the price of each order, for the full amount of shares available at

that price, or for the size of the incoming order, if smaller.

(2) If an incoming order cannot be matched when it is received and it is not designated as a type that should be immediately cancelled, the order shall be placed in the electronic book and ranked as described in Rule 4(b) above.

(3) An inbound ITS commitment, if it is priced at the current BBO in the electronic book, shall be automatically matched against the order(s) reflected in the BBO, for the full amount of shares available at that price, and any remaining portion of the ITS commitment shall be automatically cancelled; provided, however, that the inbound ITS commitment shall be automatically cancelled if its execution would occur at a price worse than the NBBO. If an inbound ITS commitment to sell is priced, at the time it is received, lower than the best bid in the electronic book or an ITS commitment to buy is priced, at the time it is received, higher than the best offer in the electronic book, the ITS commitment shall be automatically cancelled.

(4) In listed securities, orders shall only be matched at prices that are equal to, or better than, the NBBO.

(d) Submission of cross or cross with size orders. Cross or cross with size orders shall be automatically executed if they meet the requirements set out in Rule 2(b)(3) and 2(b)(4) above. If an order designated as cross or cross with size does not meet the requirements for its designation at the time it is received by the electronic book, it shall be immediately cancelled.

#### Cancellation of Transactions

Rule 5. A transaction made in demonstrable error and cancelled by both parties may be unwound, subject to the approval of the Exchange.

Unresolved controversies relating to transactions that occur in the electronic book, and which are not addressed pursuant to the procedures in Rule 7, below, shall be subject to the arbitration rules of the Exchange set out in Article VIII, Rules 23 and 24.

#### Registration of Market Makers

Rule 6. Upon application and approval by the Exchange, any Exchange floor member may register as a market maker in one or more of the securities traded in the electronic book. A market maker shall meet the following requirements and shall have the following obligations:

(a) Registration. Applicants seeking to register as electronic book market makers must submit an application on the form(s) required by the Exchange.

The Committee on Floor Procedure shall consider each application, considering factors including, but not limited to, an applicant's financial and technical resources, trading experience, personnel and disciplinary history. The Committee shall approve or disapprove each application, providing written reasons for any disapproval. If an application is not approved, the applicant may obtain review of the decision by the Exchange's Executive Committee by filing a written request for review with the Secretary of the Exchange within five business days after being notified of the disapproval.

(b) *Obligations of a market maker.* Each market maker must maintain a continuous, two-sided market in each of the securities in which he or she is registered.

(c) *Utilization of exempt credit.* Exchange members registered as electronic book market makers are registered as dealers on the Exchange for purposes of the Securities Exchange Act of 1934 and the rules and regulations under that Act.

(d) *Suspension or termination of registration.* The registration of a market maker may be suspended or terminated by the Committee on Floor Procedure based upon a finding that the market maker has not satisfactorily performed his or her responsibilities as defined in the federal securities laws and the rules of the Exchange. Proceedings to suspend or terminate the registration of a market maker shall be conducted in accordance with the procedures set out in Article XVII of the Exchange's Rules.

#### *Handling of Clearly Erroneous Transactions*

Rule 7. The Exchange will respond to requests for review of clearly erroneous transactions using the following procedures:

(a) The terms of a transaction are "clearly erroneous" where there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.

(b) Any member may request a review of an execution received through the electronic book when the member believes that the terms of the transaction were clearly erroneous when submitted.

(1) The member must make a request for review by telephone immediately after the execution and also must provide a written request, by facsimile or by e-mail, within 15 minutes after the execution.

(2) The Exchange shall promptly notify the other party to the transaction of the request for review.

(3) The member making a request for review shall provide, within 30 minutes after making the written request for

review (or within such longer period of time specified by Exchange staff), written documentation relating to the disputed transaction that is reasonably necessary for use by the Exchange in resolving the matter. The other party to the transaction shall provide, within 30 minutes after receiving notice from the Exchange of the request for review (or within such longer period of time specified by Exchange staff), written documentation relating to the disputed transaction that is reasonably necessary for use by the Exchange in resolving the matter. Once a party has submitted its documentation, and the period for providing the documentation has ended (or, if earlier, the party has notified the Exchange that it has no further information), the party may not provide additional information unless requested to do so by Exchange staff. Either party to the transaction may request, and the Exchange shall provide, the written documentation submitted by the other party.

(4) The Exchange, acting through one of its officers designated by the Chief Executive Officer, shall review the transaction and determine whether it is clearly erroneous. In making that determination, the officer shall consider the goals of maintaining a fair and orderly market and the protection of investors and the public interest.

(c) If the Exchange officer determines that a transaction is not clearly erroneous, the officer shall notify both parties, in writing, that no action will be taken with respect to the completed trade. If the Exchange officer determines that a transaction is clearly erroneous, the officer shall declare the transaction null and void or modify one or more of the terms of the transaction with the aim of trying to return the parties to the positions that they would have been in (or to positions reasonably similar to those positions) if the error had not occurred. The officer shall document this decision in writing and provide copies of the decision to all parties.

(d) Either party may appeal this determination to a subcommittee of the Exchange's Committee on Floor Procedure by submitting an appeal to the Exchange's Secretary, by facsimile or in writing, within 30 minutes after receiving the Exchange's written decision or, if the Exchange notifies parties of its decision after 3:00 p.m. (Central Time), by 8:30 a.m. (Central Time), the next trading day. Once an appeal is received, the Exchange shall notify the counterparty to the trade and both parties and the Exchange itself will be permitted to submit any additional supporting written materials up to the time that the subcommittee considers

the appeal. Either party to a disputed trade may request, and the Exchange shall provide, the written documentation presented to the subcommittee by the other party or by the Exchange. An appeal does not operate as a stay on the decision being appealed. After consideration of any written materials provided by the parties or by the Exchange, and after any hearings that the subcommittee may hold, the subcommittee, using the standards set out in this rule, shall affirm, modify or reverse the original decision. The subcommittee's decision on a matter may be appealed to the full Committee on Floor Procedure as set out in CHX Article IV, Rule 3, except that the appeal does not operate as a stay on the decision of the subcommittee. The decision of the Exchange's Committee on Floor Procedure shall be the final Exchange action on the matter. Any decision by an Exchange officer under section (c) above or by the Committee on Floor Procedure or any of its subcommittees under this section (d) shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.

(e) If there is any disruption or malfunction in the use or operation of the electronic book, or the communications systems associated with the electronic book, the Chief Executive Officer, or another officer designated by the Chief Executive Officer may declare any transaction arising out of the use of the electronic book during the period of the disruption or malfunction null and void or may modify the terms of these transactions. In making this decision, the Chief Executive Officer, or any designee, must find that the transactions were clearly erroneous or that the actions are necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest. Absent extraordinary circumstances, any action by the Chief Executive Officer or other designee shall be taken within 30 minutes of detection of the erroneous transaction, but in no event later than 2:00 p.m., Central Time, on the trading day following the date of the trade at issue. The Exchange shall notify each member involved in the transaction as soon as practicable following the decision and any party to the transaction may appeal that decision by following the procedures set out above in section (d) of this rule.

#### *Application of CHX Rules*

Rule 8. The rules and procedures in this Article shall apply to trading conducted in the electronic book.

*Unless otherwise defined in this Article, terms used in this Article shall have the same meanings given them elsewhere in the Rules. Except where the context requires otherwise, the provisions of the Constitution and all other Rules and policies of the Board of Governors shall continue to be applicable to trading that occurs in the electronic book. If any rule in this Article is inconsistent with any other provision of the Rules, the provisions of this Article shall control and shall be deemed to supplement or amend the inconsistent provision.*

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## Article XII—Discipline and Trial Proceedings

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### Minor Rule Violations

#### Rule 9.

- (a) No change to text.
- (b) No change to text.
- (c) No change to text.
- (d) No change to text.
- (e) No change to text.
- (f) No change to text.
- (g) No change to text.

(h) Exchange Rules and Policies subject to the Minor Rule Violation Plan:

#### (i) Reporting and Record Retention Violations

\* \* \* \* \*

#### (ii) Floor Decorum and Minor Trading Rule Violations

(1)–(10) No change to text.

(11) [Failure to comply with Cabinet Securities Provision (Article XX, Rule 11)] *Reserved for future use.*

\* \* \* \* \*

## ARTICLE XX

\* \* \* \* \*

### [Cabinet Securities]

Rule 11. *Reserved for future use.*

[Stocks having no designated specialist unit of trading shall be assigned for dealings by use of cabinets and shall be dealt in at a location designated for that purpose.]

[The Exchange may also designate bonds which are to be dealt in by use of cabinets.]

[Bids and offers in securities dealt in by use of cabinets shall be written on cards, which shall be filed in the cabinets in the following sequence:]

[1. According to price; and]

[2. According to the time received at the cabinet.]

[Orders in such securities shall be filled according to the bids and offers filed in the cabinets, in the sequence indicated above, except that oral bids

and offers in such securities may be made if not in conflict with bids and offers in the cabinets. Oral bids and offers may be made by clearing the cabinet post by phone provided that such bids and offers are audibly announced at the cabinet post through a speaker system maintained by the Exchange.]

[Every card placed in the cabinets shall bear a definite price and number of shares and no mark or identification shall be placed thereon to indicate it is other than a limited order at the price.]

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## ARTICLE XXVIII—Listed Securities

\* \* \* \* \*

### [Cabinet System]

Rule 6. *Reserved for future use.* [The Board of Governors may designate to be traded in the cabinet system those securities which in the judgment of the Board do not trade with sufficient frequency to warrant their retention in the specialist system and may place securities in the cabinet system on the unrestricted list. Securities on the unrestricted list may thereafter, until removed from the unrestricted list, be traded off the Floor of the Exchange without special permission from the Exchange.]

\* \* \* \* \*

## ARTICLE XXXIV—Registered Market Makers—Equity Floor

\* \* \* \* \*

### Assigned Securities

Rule 3. A registered market maker shall engage to a reasonable degree under existing circumstances in a course of dealing in the securities to which he is assigned that is reasonably calculated to contribute to the maintenance of a fair and orderly market. The Floor Procedure Committee (or other committee appointed for the purpose by the Board) shall specify the percentage of the shares purchased and sold by a registered market maker that must be of securities to which he is assigned.

\* \* \* Interpretations and Policies:

.01 No change to text.

[.02 The Committee on Floor Procedure has approved a program which provides for the dissemination of continuous two-sided quotations by Market Makers in those issues lacking a registered specialist (Cabinet Issues). In discussing the implementation of the program, the Committee recognized that definitive procedures must be set forth in order to avoid any misunderstanding concerning this program and current

Cabinet System policy. The Committee wishes to make it clear that the program is open to all floor members who are interested in seeing all Exchange issues quoted. The Committee retains the right to review the program on an ongoing basis.]

[The procedures and policies relative to this program are as follows:]

[1. A Market Maker who agrees to disseminate a continuous two-sided quotation in a Cabinet System Issues will be considered the “Post” in the issue.]

[2. The “Post” classification carries with it the obligation to accept and reflect all orders which qualify for entry on a “Post Protection” basis.]

[3. The subject issues are no longer classified as Cabinet System issues.]

[4. All current rules and policies in effect relative to clearing the Post apply with equal force with respect to the subject issues.]

[5. Limit orders will be handled under the same guidelines which apply to the handling of such orders by Specialists except for application of the Best requirement which is limited to 100 shares.]

[6. The designation of “Lead” or “Primary” Market Maker will be assigned to the first Market Maker in a given Cabinet System issue who is willing to abide by the dictates of this program.]

[7. The Lead or Primary Market Maker, as the repository for limit orders in the subject issues, will be responsible for lodging all applicable Trade Through complaints against other ITS Participants.]

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## Membership Dues and Fees

A.–L. No change to text.

M. Credits

1. Specialist Credits—No change to text

2. Floor Broker Credits—No change to text.

[3. Credits for Qualified Market Makers Registered in Cabinet Securities]

[Effective July 1, 2002, total monthly fees owed by a market maker registered in a cabinet security will be reduced (and qualified market makers will be paid each month for any unused credits) by a Transaction Credit.]

[“Transaction Credit” when used in connection with a credit for a Qualified Market Maker registered in a cabinet security means 18% of the monthly CHX tape revenue from the Consolidated Tape Association (less all direct CTA costs) generated by the security in which the market maker is registered. To the extent that CHX tape revenue is subject to a year-end

adjustment, market maker credits may be adjusted accordingly.]

["Qualified Market Maker" means a lead market maker who is registered as such in 100 or more cabinet securities.]

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#### Minor Rule Violation Plan Recommended Fine Schedule

(Pursuant to Article XII, Rule 9(e))

\* \* \* \* \*

[Failure to comply with Cabinet Securities

Provision: \$100.00, \$500.00, \$1,000.00]

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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. 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 implement a fully-automated electronic book for the display and execution of orders in securities that are not assigned to a specialist. Under the Exchange's current rules, securities that are not assigned to a specialist currently are traded in two ways: (1) Securities can be placed in the cabinet;<sup>4</sup> or (2) securities can be removed from the cabinet and assigned to a lead market maker for trading.<sup>5</sup> According to the Exchange, the procedures associated with the trading of these products are quite manual. For example, the Exchange maintains a physical location, known as the cabinet, at which written information is manually maintained regarding existing bids, offers and orders for each cabinet security. These orders are filled manually and each transaction is recorded on a written trade ticket before being entered into the Exchange's

systems for public dissemination. Securities that are assigned to lead market makers are subject to similar manual procedures, quite like those for cabinet securities, except that these orders are also entered into the Exchange's systems so that they can be automatically quoted.

The Exchange believes that these antiquated manual procedures are an extraordinarily inefficient way to trade securities that are not assigned to a specialist. As a result, the Exchange now proposes to replace these procedures with a new fully-automated electronic book that would display and match eligible limit orders in these securities, without the participation of a specialist or lead market maker. As described below, this new electronic book would allow the Exchange's members, whether or not they are on the Exchange's floor, to enter orders into an automated matching system operated by the Exchange for possible execution.

*Eligible securities and eligible orders.* Under the proposed rules, all securities eligible for trading on the Exchange that are not assigned to a specialist would be traded in the electronic book. Orders sent to the electronic book would be required to be specifically designated for handling in the electronic book.<sup>6</sup> The electronic book would accept only round-lot limit orders that are good for the day on which they are submitted.<sup>7</sup> No odd-lot orders or good-till-cancelled orders would be accepted.

Orders could be designated as "immediate or cancel" or "fill or kill" orders to ensure that they are immediately filled or cancelled.<sup>8</sup> Orders could also be designated as "cross" or "cross with size" to permit the handling of orders to buy and sell the same security.<sup>9</sup> Orders could not be designated with any other conditions.

<sup>6</sup> See Proposed CHX Article XXA, Rule 2 (requiring orders to be specifically designated, in the manner specified by the Exchange, to confirm that they are eligible for trading in the electronic book).

<sup>7</sup> See Proposed CHX Article XXA, Rule 2.

<sup>8</sup> An immediate or cancel order would be executed, in whole or in part, as soon as it is received by the electronic book; if execution is not possible, or if only a partial execution is possible, any unexecuted balance of the order would be immediately cancelled. A fill or kill order would be executed in full as soon as it is received; if execution is not possible, the entire order would be immediately cancelled. See Proposed CHX Article XXA, Rule 2(b)(1) and (2).

<sup>9</sup> A "cross" order would be an order to buy and sell the same security at a specific price that is equal to or better than the National Best Bid or Offer ("NBBO") and better than the best bid and offer displayed in the electronic book. A "cross with size" order would be an order to buy and sell at least 25,000 shares of the same security (a) at a price equal to or better than both the NBBO and the best bid or offer ("BBO") displayed in the electronic

book; (b) where the size of the order is larger than the aggregate size of all interest displayed in the electronic book at that price; and (c) where neither side of the order is for the account of the CHX member sending the order to the electronic book. These definitions are substantially similar to the descriptions of the types of cross transactions that can occur today on the Exchange's floor without interference from the trading crowd. See CHX Article XX, Rule 23. Because there would not be a trading crowd operating in connection with the electronic book, however, the Exchange has not incorporated other aspects of its existing crossing rules, such as the requirement for asking the crowd for a market before executing a crossing transaction between the quoted market. Similarly, because there would not be a trading crowd or specialist's post in these issues, the Exchange has not incorporated rules relating to instances where a specialist or other floor member can break up the crossing transaction by providing an improved price to one side of the proposed trade. In the electronic book, all bids and offers would be reflected in the book itself—there would be no on-floor auction market trading in these issues.

*Operating hours.* Under the proposed rules, the electronic book would operate during the Exchange's Primary Trading Session and its Post-Primary Trading Session.<sup>11</sup> Specifically, the electronic book would accept orders on each day for a particular security once the primary market in that security opens on a quote or a trade.<sup>12</sup> The electronic book would close at 3:30 p.m. (central

book; (b) where the size of the order is larger than the aggregate size of all interest displayed in the electronic book at that price; and (c) where neither side of the order is for the account of the CHX member sending the order to the electronic book. These definitions are substantially similar to the descriptions of the types of cross transactions that can occur today on the Exchange's floor without interference from the trading crowd. See CHX Article XX, Rule 23. Because there would not be a trading crowd operating in connection with the electronic book, however, the Exchange has not incorporated other aspects of its existing crossing rules, such as the requirement for asking the crowd for a market before executing a crossing transaction between the quoted market. Similarly, because there would not be a trading crowd or specialist's post in these issues, the Exchange has not incorporated rules relating to instances where a specialist or other floor member can break up the crossing transaction by providing an improved price to one side of the proposed trade. In the electronic book, all bids and offers would be reflected in the book itself—there would be no on-floor auction market trading in these issues.

<sup>10</sup> Similarly, if an order in a listed security locks or crosses the BBO in the electronic book at the time it is received, but not the NBBO, the order would be executed according to the electronic book's matching algorithm, and any remaining portion would be immediately cancelled, if it would lock or cross the NBBO.

<sup>11</sup> The Exchange's Primary Trading Session is open, for a particular security, during the same times that such security is traded on its primary market (e.g., 8:30 to 3 p.m. central time, for most securities). The Exchange's Post-Primary Trading Session operates until 3:30 p.m. See CHX Article IX, Rule 10(b).

<sup>12</sup> The proposed rules define the primary market as the listing market for a security, unless otherwise designated by the Rules Subcommittee; *provided, however*, that if a security is traded by the New York Stock Exchange, Inc. ("NYSE"), then the primary market for such security would be the NYSE and if a security is traded by the American Stock Exchange LLC ("Amex"), then the primary market for such security would be the Amex. If a security is traded on both the NYSE and the Amex, whichever of the two is the listing market would be considered the primary market. If a security is listed on both the NYSE and The Nasdaq Stock Market, Inc. ("Nasdaq"), the NYSE would be considered the primary market. See Proposed CHX Article XXA, Rule 3(b).

<sup>4</sup> See CHX Article XX, Rule 11.

<sup>5</sup> See CHX Article XXXIV, Rule 3, Interpretation and Policy .02. Among other things, market makers assigned to these former cabinet securities are required to engage, to a reasonable degree under existing circumstances, in a course of dealing that is reasonably calculated to contribute to the maintenance of a fair and orderly market.

time), and all unexecuted orders would be automatically cancelled.

**Routing of orders.** Orders could be sent to the electronic book through the Exchange's MAX system or through any other communications lines approved by the Exchange for the delivery of orders by Exchange members.<sup>13</sup> The Exchange anticipates that all CHX members—whether they are located on the Exchange's trading floor or off the floor—would be able to receive access to the electronic book. The electronic book would also accept and automatically execute commitments sent by market centers that participate in the ITS. National Association of Securities Dealers, Inc. ("NASD") market participants would have direct

telephone access to the supervisory center for the electronic book to enter orders, as required by the OTC/UTP Plan.<sup>14</sup>

**Ranking and display of orders.** All orders received by the electronic book would be ranked according to their price and time of receipt and would be displayed to the public when they constitute the BBO in the electronic book for a security.<sup>15</sup> The Exchange initially plans to disseminate these best bids and offers through the systems used for that purpose today—through the CTA/CQ Plan for listed securities, and through the OTC/UTP Plan for Nasdaq/NM securities.

**Automated matching of orders.** In the electronic book, orders would

automatically match against each other, in price/time priority.<sup>16</sup> Specifically, an incoming order would be matched against one or more orders in the electronic book, in the order of their ranking, at the price of each order, for the full amount of shares available at that price, or for the size of the incoming order, if smaller. If an incoming order could not be matched when it is received, and it is not designated as an order that should be immediately cancelled, the order would be placed in the electronic book. For example:

Assume that the electronic book contains the following bids and offers in a particular security, FAA:

Buy	Price	Price	Sell
200 .....	\$47.50	\$48.20	400
1,500 .....	47.00	48.50	700
600 .....	46.75	49.00	100

—An incoming limit order to buy 500 shares at a price of \$48.00 would become the top-of-the-book best bid.

—An incoming limit order to buy 500 shares at a price of \$48.20 would match for 400 shares against the top-of-the-book best offer at a price of \$48.20, leaving 100 shares to buy at \$48.20.

Inbound ITS commitments would be automatically matched against the order(s) reflected in the electronic book's BBO for the full amount of shares at that price, and any remaining portion of the ITS commitment would be automatically cancelled. An ITS commitment, however, would be automatically cancelled if its execution would occur at a price worse than the NBBO or if it is hypermarketable at the time it is received.<sup>17</sup> Importantly, to ensure that the electronic book does not trade through another market in violation of the ITS Plan's trade-through provisions, orders in listed securities would only be matched at prices that are equal to, or better than, the NBBO.

Cross or cross with size orders would be automatically executed if they meet

the requirements for those types of orders. If they do not meet applicable requirements, they would be immediately cancelled.

**No distinction between agency and professional orders.** Under the proposed rules, agency orders (entered on behalf of a customer) and professional or proprietary orders (entered for the account of a CHX member or other broker-dealer) would be handled in an identical way in the electronic book's matching algorithms.<sup>18</sup>

**Cancellations of transactions and handling of clearly erroneous transactions.** Under the proposed rules, members that make a transaction in demonstrable error could agree to cancel and unwind the transaction, subject to the approval of the Exchange.<sup>19</sup> For

purposes of the electronic book, the Exchange also proposes to adopt a policy for the handling of clearly erroneous transactions.<sup>20</sup> This policy would allow the Exchange to (a) review, and potentially modify or cancel, executions where one party believes that the terms of the transaction were clearly erroneous when submitted; and (b) modify or cancel executions that result from a disruption or malfunction in the use or operation of the electronic book, or any communications system associated with the electronic book. The proposed rules set out procedures for each of these reviews, including specific means for members to appeal the Exchange's decisions.<sup>21</sup>

<sup>13</sup> See Proposed CHX Article XXA, Rule 4(a)(1).

<sup>14</sup> See CHX Article XX, Rule 43.

<sup>15</sup> See CHX Proposed Article XXA, Rule 4(b).

<sup>16</sup> The only exception to this price/time priority matching would occur when certain "cross with size" orders are executed. In those instances, eligible "cross with size" transactions—where there is an order to buy and sell at least 25,000 shares of the same security (A) at a price equal to or better than both the NBBO and the BBO displayed in the electronic book; (B) where the size of the order is larger than the aggregate size of all interest displayed in the electronic book at that price; and (C) where neither side of the order is for the account of the CHX member sending the order to the electronic book—could execute at the price of orders in the electronic book, without executing those earlier-received orders. Because this type of crossing transaction is permitted on the floor of the Exchange today, the Exchange believes it is

appropriate to include this transaction type in the fully-automated electronic book.

<sup>17</sup> In other words, if an inbound ITS commitment to sell is priced, at the time it is received, lower than the best bid in the electronic book, or an ITS commitment to buy is priced, at the time it is received, higher than the best offer in the electronic book, the ITS commitment would be automatically cancelled.

<sup>18</sup> The Exchange believes that this handling is appropriate because the electronic book is a fully-automated functionality of the Exchange. Orders for the electronic book would be submitted directly and electronically to the Exchange. Once transmitted, an order could be cancelled, but a member could not influence the execution of that order in any way. The orders would enter a line of other orders to be matched against one another based on an established algorithm.

<sup>19</sup> See Proposed CHX Article XXA, Rule 5.

<sup>20</sup> See Proposed CHX Article XXA, Rule 7.

<sup>21</sup> For example, a member seeking review of a "clearly erroneous" transaction would be required to notify the Exchange of the request, by telephone and in writing, promptly after the execution. After reviewing the transaction, an Exchange official would notify both parties of his or her decision, in writing; either party could appeal the decision to a subcommittee of the Exchange's Committee on Floor Procedure and, if not satisfied, to the full Committee on Floor Procedure. In making his or her decision, the Exchange official would consider the goals of maintaining a fair and orderly market and protecting investors and the public interest. If an Exchange official determines that a transaction was clearly erroneous, he or she would try to return the parties to the positions that they would have been in (or positions reasonably similar to those positions) if the error had not occurred. Similarly,

*Registration of market makers.* Under the proposal, Exchange members could seek registration as market makers in one or more of the securities traded in the electronic book. A market maker would be required to maintain a continuous two-sided market in each security in which he or she is registered and would be entitled to utilize exempt credit for financing their market maker transactions. The proposed rules would set out a process for market makers to apply for this registration and for the suspension or termination of their registrations, where appropriate.<sup>22</sup>

*Additional changes to rules.* Because this proposal is designed to replace the Exchange's existing cabinet security and lead market maker systems, this submission also contains proposed changes to various rules associated with those trading systems.<sup>23</sup>

The Exchange represents that it has designed this electronic book to be a fully-automated system that would permit eligible orders in eligible securities to match against one another, without the required participation of a specialist or lead market maker. The Exchange believes that this system functionality would provide all Exchange members with an efficient way to trade securities that are not assigned to a specialist and would protect investors and the public interest by automatically handling orders in a fair and reasonable manner.

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act<sup>24</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>25</sup> in particular, because it is designed to promote just and equitable principles of

in the event of disruption or malfunction that impacts the operation or use of the electronic book, an Exchange official could act promptly to declare transactions void or to modify transactions. The official would be required to notify each member involved in the transaction as soon as practicable after making any decision. Decisions could be appealed using the procedure set out for the review of decisions addressing clearly erroneous transactions.

<sup>22</sup> See Proposed CHX Article XXA, Rules 6(a) and (d).

<sup>23</sup> See proposed changes to CHX Article XII, Rule 9 (deleting the cabinet securities rule from the Minor Rule Violation Plan ("MRVP")); CHX Article XX, Rule 11 (deleting the cabinet securities rule); CHX Article XXVIII, Rule 6 (deleting the rule permitting the Board of Governors to place securities in the cabinet); CHX Article XXXIV, Rule 3 (deleting the interpretation that creates the lead market maker program); and Schedule of Membership Dues and Fees (deleting the lead market maker credits and the recommended MRVP fines for violations of the cabinet system rule).

<sup>24</sup> 15 U.S.C. 78f(b).

<sup>25</sup> 15 U.S.C. 78f(b)(5).

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, as amended, 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, as amended.

## 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 Exchange 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](mailto:rule-comments@sec.gov). Please include File Number SR-CHX-2004-11 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-2004-11. 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-2004-11 and should be submitted on or before August 9, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>26</sup>

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 04-16322 Filed 7-16-04; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50006; File No. SR-DTC-2004-03]

### Self-Regulatory Organizations; The Depository Trust Company; Order Granting Approval of Proposed Rule Change Relating to the Processing of Deliveries in DTC's Money Market Instrument Program

July 12, 2004.

On March 18, 2004, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") proposed rule change File No. SR-DTC-2004-03 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposed rule change was published in the **Federal Register** on May 20, 2004.<sup>2</sup> No comment letters were

<sup>26</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> Securities Exchange Act Release No. 49709 (May 14, 2004), 69 FR 29155 (May 20, 2004).