

## 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 CHX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it had received regarding the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The 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

#### Purpose

The proposed change to the CHX fee schedule would provide for continued assessment of a marketing fee, in an amount equal to \$.01 per share, applicable to transactions occurring on or before December 31, 2003. The marketing fee would apply only to "Subject Transactions"<sup>3</sup> in "Subject Issues"<sup>4</sup> and would not be assessed if the specialist trading the Subject Issue elected to forego collection of the marketing fee.

The CHX currently assesses a marketing fee under a provision of the CHX fee schedule that, by its terms, expires on December 31, 2002.<sup>5</sup> Under the system currently in place, the CHX calculates, bills, and collects the marketing fee and remits the proceeds to

the specialist firm trading the Subject Issue. The specialist firm then distributes the funds to order-sending firms in accordance with its payment-for-order flow arrangements relating to the Subject Issue (and possibly also to market makers who contribute to market share growth in certain instances).<sup>6</sup> The remaining undistributed funds in excess of \$1000 are refunded, on a quarterly basis, to the paying parties pro rata, in proportion to the fees they have paid.

The CHX notes that the proposed marketing fee provision does not differ from the previous versions, except that it would extend application of the marketing fee through December 31, 2003. The CHX intends that the continued imposition of the marketing fee will allocate equitably the financial burden of seeking order flow for Subject Issues. According to the CHX, in the absence of the marketing fee the CHX specialist trading a Subject Issue is the sole bearer of the often substantial costs associated with attracting order flow to the CHX, as well as the licensing fees that the licensor of the product imposes.<sup>7</sup> CHX market makers participating in transactions in Subject Issues, conversely, do not currently share any of these costs. The proposed rule change would allow a specialist trading a Subject Issue to elect or decline imposition of the marketing fee depending on whether the specialist believes it is appropriate for a part of the financial burden of trading the Subject Issue to be allocated among those trading the Subject Issue. The CHX anticipates that the proposed rule change will continue to provide specialists trading Subject Issues with sufficient incentive to continue their efforts to attract additional order flow and increase market share.

#### Statutory Basis

The CHX believes that the proposed rule change is consistent with section 6(b)(4) of the Act<sup>8</sup> in that it provides for the equitable allocation of reasonable

dues, fees and other charges among its members.

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

The CHX believes that the proposed rule change will not 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 Regarding the Proposed Rule Change Received From Members, Participants or Others

The CHX has not received any written comments with respect to the proposed extension of the marketing fee program.

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

The foregoing rule change establishes or changes a due, fee, or other CHX charge and therefore has become effective pursuant to section 19(b)(3)(A) of the Act<sup>9</sup> and Rule 19b-4(f)(2) thereunder.<sup>10</sup> At any time within 60 days after the filing of the rule change, the Commission may summarily abrogate the 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.

## 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. 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 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 at the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to File No.

<sup>3</sup> "Subject Transaction" means (a) any trade with a customer, whether the contra party is a specialist or a market maker, where the order is delivered to the CHX via the MAX system or where compensation is paid to induce the routing of the order to the CHX; or (b) any trade between a specialist and a market maker in which the market maker is exercising rights under the market maker entitlement rules.

<sup>4</sup> "Subject Issue" means any issue which constitutes an exchange-traded fund and meets the following two criteria: (a) average daily share volume in the issue exceeds 150,000 shares each month during a consecutive two month period; and (b) market maker share participation in the same issue exceeds 5% for each month during the same two-month period.

<sup>5</sup> See Securities Exchange Act Release No. 44646 (August 2, 2001), 66 FR 41641 (August 8, 2001) (SR-CHX-2001-10) (announcing immediate effectiveness of the new marketing fee provision to the CHX fee schedule through December 31, 2001); Securities Exchange Act Release No. 45282 (January 15, 2002), 67 FR 3517 (January 24, 2002) (SR-CHX-2001-30) (extending program through June 30, 2002); Securities Exchange Act Release No. 46233 (July 19, 2002), 67 FR 48960 (July 26, 2002) (SR-CHX-2002-19) (extending program through July 31, 2002); and Securities Exchange Act Release No. 46297 (August 1, 2002), 67 FR 51612 (August 8, 2002) (SR-CHX-2002-25) (extending program through December 31, 2002).

<sup>6</sup> See Securities Exchange Act Release No. 44646 (August 2, 2001), 66 FR 41641 (August 8, 2001) (SR-CHX-2001-10) (describing potential arrangements between specialists and market makers). According to the CHX, no such arrangements are currently in place. Conversation between Kathleen M. Boege, Associate General Counsel, CHX, and Gail Fortson, Paralegal Specialist, Division of Market Regulation, Commission, on January 10, 2003.

<sup>7</sup> The CHX's marketing fee program applies only to exchange-traded fund products, which virtually always have an associated licensing fee. Currently, the marketing fee is assessed only against the Nasdaq-100 Index exchange-traded fund, commonly known as "QQQ."

<sup>8</sup> 15 U.S.C. 78f(b)(4).

<sup>9</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>10</sup> 17 CFR 19b-4(f)(2).