

center designated by the CHX specialist, and approved by the Exchange.

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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 CHX included statements concerning the purpose of and basis for its proposal and discussed any comments it received regarding the proposal. 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

1. Purpose

The CHX proposes to permit a CHX specialist to enable a functionality that would automatically execute designated limit orders for OTC securities, following dissemination of a locking or crossing quotation in that security by one or more designated OTC market centers.

Under existing CHX rules relating to listed securities, limit orders that are resident in the CHX specialist's book are entitled to a fill at the limit price if a price penetration (*i.e.*, a trade-through) or certain other conditions occur in the primary market.⁷ Although there is not an analogous trade-through rule in the OTC market, and therefore no analogous limit order protection provisions currently set forth in the CHX rules, certain CHX specialists desire to provide such protections in instances where one or more designated OTC market centers disseminate a quotation that locks or crosses the CHX specialist's quotation.⁸

Accordingly, a subcommittee of the CHX OTC Committee undertook to

evaluate the issue, and to design a functionality that, if enabled by a CHX specialist, would automatically execute certain resting limit orders for OTC securities. The proposed rule change, which was discussed extensively by the CHX OTC Committee and other member committees, would permit a CHX specialist to enable such a functionality on a voluntary basis. The functionality would automatically execute designated resting limit orders, if the designated OTC markets lock or cross the CHX quotation.⁹ The type of orders and the total number of shares to be executed automatically would be designated by the CHX specialist; orders not eligible for automatic execution would remain in the specialist's book and would be eligible for manual execution.¹⁰

The CHX believes that the proposed rule change will be welcomed by its

⁹ Because there is no primary market for over-the-counter securities, the CHX has not simply designated the "primary market" as the market that would trigger limit order protection on the CHX. Instead, this rule would allow CHX specialists to identify the designated market, with the approval of the Exchange, on an issue-by-issue basis. Initially, all CHX specialists have identified the "Designated Market" as the Nasdaq Stock Market. If all CHX specialists make a different or additional designation for all securities traded on the Exchange, the Exchange will notify its order-sending firms of those Exchange-wide changes and file those changes with the Commission as an interpretation of an existing rule pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) thereunder. If, however, CHX specialists respond to the fragmentation in the market by identifying different designated markets for different securities, the Exchange will file, pursuant to Rule 19b-4(f)(1), a new interpretation confirming that specialists have identified different designated markets in different securities for purposes of this voluntary designation, but will not list all of those different designations.

¹⁰ In addition to permitting the new functionality described above, the proposed rule change provides for a modification of the CHX rule governing priority of same-priced orders. This modification contemplates that, on an issue-by-issue basis, specialists could designate certain same-priced orders as eligible for automatic execution, while other orders might not be so designated, thus automatically executing some orders out of traditional time-price priority sequence.

For instance, if a specialist designates all limit orders in an issue under 10,000 shares as eligible for possible auto-execution under this rule, those orders of 10,000 shares or more would not be eligible for automatic execution and thus would remain in the specialist's book, eligible for manual execution, even though a smaller order at the same price that was received at a later time would be eligible for automatic execution (up to the size of the Limit Order Auto Execution Threshold).

Because the CHX specialist is not obligated (under CHX rules, the Act or any other governing rules) to execute OTC limit orders based on conditions in other OTC market centers, rendering engagement of this proposed functionality strictly voluntary, the Exchange believes that it is appropriate for a CHX specialist to condition automatic execution in a manner that could, based on issue-by-issue designations of certain types of orders, modify the precedence of same-priced orders.

order-sending firms, as it will provide for protection of certain limit orders on a voluntary basis in the OTC market, which currently does not require that such protections be afforded limit orders. Indeed, the CHX believes that the proposed rule change, which could dramatically increase the number of limit orders executed automatically on the CHX (which currently does not have a rule requiring automatic execution of limit orders for OTC securities based on conditions in other market centers), is to the material benefit of the investing public. The CHX believes that the proposed rule change constitutes a reasoned approach to offering execution guarantees in an evolving OTC market, and anticipates that many of its OTC specialists will elect to enable the functionality contemplated by the proposed rule change.

2. Statutory Basis

The CHX believes the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of section 6(b).¹¹ In particular, the CHX believes the proposal is consistent with section 6(b)(5) of the Act¹² in that it is designed to promote just and equitable principles of trade, to remove impediments to, 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.

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

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

C. Self-Regulatory Organization's Statement on Comments on 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

Because the foregoing proposed rule change does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) Impose any significant burden on competition; and
- (iii) Become operative for 30 days from the date on which it was filed, or

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

⁷ See CHX Article XX, Rule 37(a)(3). The limit order would be filled on the CHX at the limit price regardless of whether the CHX specialist was able to obtain recourse via the Intermarket Trading System ("ITS") administrative process following the trade-through.

⁸ A designated market's bid (offer) will lock the CHX specialist's quote if it equals the CHX specialist's offer (bid). A designated market's bid (offer) will cross the CHX specialist's quote if it penetrates the CHX specialist's offer (bid). The CHX will consider a designated market to have locked or crossed a CHX specialist's quote each time that it moves from an unlocked/uncrossed state to a locked or crossed state. For example, if a designated market crosses a CHX specialist's offer at 52 with a 53 bid, it will not again cross the CHX's, for purposes of this rule, if the designated market continues to cross the CHX's offer with a bid of 54.