

Interpretation .01, to modify the rule language in light of the current \$0.01 minimum price variation in quoted spreads.⁷ In addition, the proposed rule change would codify certain of the Exchange's stated policies and interpretations contained in CSE Regulatory Circulars.⁸ Rule 11.9(u), Interpretation .01, which applies only to ITS eligible securities, requires Preferencing Designated Dealers ("PDDs") in greater than minimum price variation spreads between the national best bid and offer ("NBBO") to, except under unusual market conditions or if it is not in the best interest of the customer, either immediately execute a market order at an improved price or expose it on the Exchange for a minimum of fifteen seconds.⁹

The Market Order Exposure Requirement was adopted when the industry minimum price variation was one-eighth of a dollar (\$0.125) resulting in the CSE's market order exposure rule applying when bid/ask spreads were one-fourth of a dollar (\$0.25).¹⁰ Given the advent of decimal pricing and today's narrow spreads, the CSE proposes to update its rule. The CSE seeks to reduce the exposure period from 15 seconds to 5 seconds and to impose the Market Order Exposure Requirement based on the size of the market order received by the CSE PDDs. Specifically, the CSE proposes a three-tiered application of the rule to require PDDs to: (1) Expose for 5 seconds or execute immediately at an improved price market orders of 1000 shares or less received when the NBBO is more than 5 cents (\$0.05) wide; (2) expose for 5 seconds or execute immediately at an improved price market orders with share size between 1001 and 5000 shares received when the NBBO is more than 10 cents (\$0.10) wide; and (3) expose for 5 seconds or execute immediately at an improved price market orders with size greater than

5001 shares when the NBBO is more than 15 cents (\$0.15) wide.¹¹

As noted above, the CSE's Market Order Exposure Requirement anticipates that certain market conditions preclude application of the rule. The rule carves out these market conditions by providing that: "[e]xcept under unusual market conditions or if it is not in the best interests of the customer * * *"¹² Over the years, the CSE has disseminated Regulatory Circulars describing the Exchange's interpretations of "unusual market conditions" or when "it is not in the best interests of the customer" to expose a market order.¹³ The CSE proposes now to incorporate these interpretations into the language of the rule. Therefore, to assist PDDs in satisfying their obligations under the rule, the following exceptions apply:

Unusual Market Conditions

Unusual market conditions include the following conditions:

1. The NBBO is more than 1 dollar (\$1.00) wide at receipt;
2. the market is locked or crossed at receipt or becomes that way during exposure;
3. when circuit breakers have been activated;
4. during and immediately after the opening (a period not to exceed 5 minutes);
5. immediately prior to the close (a period not to exceed 5 minutes);
6. when the exchange has declared a fast market; and
7. when non-firm markets exist.

Best Interests of the Customer

In order to protect the best interests of the customer, the following orders may require unique handling subject to the application of a member's brokerage judgment and experience as set forth by CSE Rule 12.10, Best Execution:¹⁴

1. block size market orders as defined in the Intermarket Trading System Plan;
2. odd-lot orders;
3. contingent orders;
4. a market order for a quantity that exceeds the existing NBBO size;
5. NBBO moves in direction of market order stop price; and
6. primary market trades at market order stop price.

1. Statutory Basis

The Exchange believes that the proposed rule change is consistent with

the provisions of Section 6(b) of the Act,¹⁵ in general, and with Section 6(b)(5) of the Act,¹⁶ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a free and open market and a national market system and, generally, in that it protects investors and the public interest.

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

The CSE does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were neither solicited nor received.

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

The foregoing proposal has become effective pursuant to Section 19(b)(3)(A)(i) of the Act,¹⁷ and Rule 19b-4(f)(1)¹⁸ thereunder, in that it constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within 60 days of the filing of the 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.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal 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

⁷ While over time the minimum trading increment has decreased from one-eighth to subpenny increments, under the current interpretation the requirements of Rule 11.9(u) Interpretation .01 remain applicable only when the price variation in the spread between the best national bid and offer is greater than or equal to one-fourth of a dollar (\$0.25). See CSE Regulatory Circular 97-07; see also Securities Exchange Act Release Nos. 39720 (March 4, 1998), 63 FR 11942 (March 11, 1998)(SR-CSE-97-13); 43471 (October 20, 2000), 65 FR 64463 (October 27, 2000) (SR-CSE-00-08); and 43653 (December 1, 2000), 65 FR 77055 (December 8, 2000) (SR-CSE-00-08) (each of which references CSE Regulatory Circular 97-07 for further discussion of CSE's Market Order Exposure Requirement).

⁸ See *supra*, note 5.

⁹ This provision applies only to public agency buy/sell market orders in securities other than Nasdaq national market securities.

¹⁰ See *supra*, note 7.

¹¹ In a separate rule filing, SR-CSE-2003-10, CSE is proposing to eliminate the Market Order Exposure Requirement completely.

¹² CSE Rule 11.9(u), Interpretations and Policies .01.

¹³ See *supra*, note 5.

¹⁴ CSE Rule 12.10, Best Execution.

¹⁵ 15 U.S.C. 78f(b).

¹⁶ 15 U.S.C. 78f(b)(5).

¹⁷ 15 U.S.C. 78s(b)(3)(A)(i).

¹⁸ 17 CFR 240.19b-4(f)(1).