

notice is hereby given that on August 1, 2003, the Chicago Stock Exchange, Incorporated ("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. The Exchange submitted an amendment to the proposed rule change on November 6, 2003.<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 Exchange proposes to amend CHX Article XX, Rule 37(a)(4), which governs execution of preopening orders on the CHX. Specifically, the CHX seeks to modify the definition of "preopening order" to provide that preopening orders for Nasdaq/NM securities must be received at or prior to 8:20 a.m. (CT), instead of the 8:25 (CT) deadline currently set forth in the rule.<sup>4</sup> Below is the text of the proposed rule change, as amended. New language is *italicized*, and deletions are bracketed.

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### **Chicago Stock Exchange Rules**

#### **ARTICLE XX**

#### **Regular Trading Sessions**

#### **Guaranteed Execution System and Midwest Automated Execution System RULE 37.**

- (a) No change to text.  
1-3. No change to text.

4. Preopenings. Preopening orders in Dual Trading System issues must be accepted and filled at the primary market opening trading price. In trading halt situations occurring in the primary market, orders will be executed based upon the reopening price. Preopening orders in NASDAQ/NM securities must be accepted and filled on a single price opening at or better than the NBBO at the first unlocked, uncrossed market. In trading halt situations, orders will be executed based on the Exchange reopening price. For purposes of this rule, (a) pre-opening orders in Dual Trading System Issues are orders that are received before a primary market opens a subject security based on a print

or based on a quote and (b) preopening orders in NASDAQ/NM securities are orders received at or prior to 8:20 [25] a.m. (Central Time) on the date of the opening.

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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 the proposed rule change, as amended, 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 seeks to amend CHX Article XX, Rule 37(a)(4), which governs execution of preopening orders on the CHX, by modifying the definition of "preopening order" to provide that preopening orders for Nasdaq/NM securities must be received at or prior to 8:20 a.m. (CT), instead of the 8:25 (CT) deadline currently set forth in the rule.

Under the current version of the CHX rule, all preopening orders for Nasdaq/NM securities are accepted and filled on a single price opening at or better than the national best bid or offer ("NBBO") at the first unlocked, uncrossed market. The Exchange represents that the single price opening for preopening orders was enacted voluntarily by the Exchange in early 2001<sup>5</sup> as an execution guarantee similar to the Exchange's provisions relating to price improvement. The Exchange believes that the single price opening, like price improvement, often provides for execution of preopening orders at execution prices more favorable than if the Exchange did not offer a single price opening. The Exchange's 2001 submission established an 8:25 (CT) deadline for preopening orders. Orders received after 8:25 (CT) are treated as standard market orders under the Exchange's general rules governing execution of market orders.

The proposed change to the rule governing the 8:25 (CT) deadline for preopening orders was formulated by

the Exchange's OTC Subcommittee, which is composed of CHX specialists who trade Nasdaq/NM securities. The members of the OTC Subcommittee believe that an earlier deadline for preopening orders is a modest yet important modification to their single price execution guarantee for preopening orders.

To place their request in context, the CHX represents that it is virtually the only market center that guarantees a single price opening at or better than the NBBO at the first unlocked, uncrossed market. The Exchange's competitors generally base their execution of preopening orders on the prices and order imbalances within their own systems, rather than the NBBO for Nasdaq/NM securities. Accordingly, the Exchange believes that its OTC specialists bear a significantly higher degree of risk with respect to preopening orders, since they are obligated to execute such orders based on the first unlocked, uncrossed NBBO. In situations where there is a significant imbalance in preopening orders for a particular issue, this execution guarantee can result in significantly adverse swings in a CHX specialist's position. The Exchange believes that an earlier deadline for preopening orders, by operating to reduce the aggregate amount of preopening orders received by a CHX specialist, would better enable the CHX specialist to manage his position and to better fulfill his specialist duties by giving him time to fully evaluate his position and to make a professional price assessment that would inform his executions once trading commences for the day.<sup>6</sup>

An additional reason for an 8:20 (CT) deadline relates to the operation of NASDAQ's SuperMontage® system, in which the CHX participates. The SuperMontage rules establish 8:20:00 (CT) through 8:29:59 (CT) as the time period during which NASDAQ market makers (including electronic communication networks) can route "trade or move" messages to SuperMontage participants whose quotes might be inferior in price to a price that another participant seeks to

<sup>6</sup> Significantly, an order received prior to the open which is not a "preopening" order (*i.e.*, which is received between the preopening order deadline and the 8:30 (CT) open) must still be executed in accordance with the Exchange's BEST rule (CHX Article XX, Rule 37(a)), which requires execution of market and marketable limit orders at the NBBO, or requires a CHX specialist to act as agent for the order to obtain the best available price in the marketplace, using order routing systems where appropriate. The CHX thus does not anticipate that such orders would be disadvantaged in terms of price once they are executed following the open; the orders simply would not participate in the single price opening.

<sup>3</sup> See letter from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated November 4, 2003, replacing Form 19b-4 in its entirety ("Amendment No. 1"). In Amendment No. 1, the CHX expands upon the purpose of the proposed rule change.

<sup>4</sup> All times referred to in the proposed rule change, as amended, are Central Time (CT).

<sup>5</sup> See Securities Exchange Act Release No. 44062 (March 12, 2001), 66 FR 15514 (March 19, 2001).