

Proposed Rule Change by Chicago Stock Exchange
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input checked="" type="checkbox"/>	Amendment <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input type="checkbox"/>	Section 19(b)(3)(A) <input checked="" type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
Pilot <input checked="" type="checkbox"/>			Rule		
Extension of Time Period for Commission Action <input type="checkbox"/>			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
Date Expires <input type="text"/>			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input checked="" type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description
Provide a brief description of the proposed rule change (limit 250 characters).

Extension of pilot rule change that permits CHX specialists to manually execute orders in exempt ETFs at a price other than the NBBO.

Contact Information
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
 Title
 E-mail
 Telephone Fax

Signature
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date
 By Vice President & Associate General Counsel
 (Name) (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

File No.: SR-CHX-2004-43
Submitted: December 20, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 19b-4

Proposed Rule Change

By

CHICAGO STOCK EXCHANGE, INCORPORATED

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

Item 1. Text of Proposed Rule Change

- (a) The Chicago Stock Exchange, Incorporated (the “CHX” or the “Exchange”), pursuant to Rule 19b-4 of the Securities Exchange Act of 1934 (the “Act”), hereby submits a request for extension of a pilot rule change relating to CHX Article XX, Rule 37(a), which governs manual execution of eligible market and marketable limit orders. The pilot rule change, which will remain in effect for an additional 60-day pilot period, permits a CHX specialist, acting in their principal capacity, to manually execute an incoming market or marketable limit order in one of three exchange-traded funds at a price other than the national best bid or offer.
- (b) Not applicable.
- (c) Not applicable.

Item 2. Procedures of Self-Regulatory Organization

- (a) The proposed rule change was approved by the unanimous written consent of the Executive Committee of the Exchange’s Board of Governors. No further approval is required.
- (b) Questions and comments on the proposed rule change should be directed to David C. Whitcomb, Jr., Senior Vice President and Chief Regulatory Officer of the Exchange, at 312/663-2628.

Item 3. Self-Regulatory Organization’s Statement on the Purpose of, and Statutory Basis for, the Proposed Rule Change.

- (a) On August 28, 2002, the Commission issued an order granting a *de minimis* exemption (the “Exemption”) for transactions in certain exchange-traded funds (“Exempt ETFs”)¹ from the trade-through provisions of the Intermarket Trading System (“ITS”) Plan. See SEC Release No. 46428 (August 28, 2002).²

As stated by both Commission staff and commissioners at an open meeting on August 27, 2002, rapid-fire quotations and executions in

¹ The three affected Exempt ETFs are the exchange-traded funds tracking the Nasdaq-100 Index (“QQQ”), the Dow Jones Industrial Average (“DIAMONDS”) and the Standard & Poor’s 500 Index (“SPDRs”).

² At present, the Exemption extends to transactions that are “executed at a price that is no more than three cents lower than the highest bid displayed in CQS and no more than three cents higher than the lowest offer displayed in CQS.”

Exempt ETFs occur consistently throughout the trading day within a range around the NBBO, rendering it extremely difficult, if not impossible, to access liquidity at an exact NBBO price point. Compounding the “flickering” noted by the Commission, the Exchange has noted a marked increase in the incidence of locked and crossed markets in Exempt ETFs.

CHX Article XX, Rule 37(a), commonly referred to as the Exchange’s “Best Rule,” requires that with respect to any market or marketable limit order not executed automatically, a CHX specialist must “. . . either (a) manually execute such order at a price and size equal to the NBBO price and size the time the order was received; or (b) act as agent for such order in seeking to obtain the best available price for such order on a marketplace other than the Exchange, using order routing systems where appropriate.”

Given the unique environment in which the ETFs are traded, and the difficulty that CHX specialists often encounter in accessing NBBO price points, the Exchange’s Department of Market Regulation (the “Department”) believes that its enforcement of the Best Rule must take the ETF trading environment into account when the Department evaluates the execution prices of eligible market and marketable limit orders for Exempt ETFs. The Department believes that in certain instances, execution of an order in an Exempt ETF at a price other than the NBBO may nonetheless be consistent with the specialist’s best execution obligation, in light of the unique environment that characterizes trading in Exempt ETFs. The Exchange believes that the current version of the BEST Rule contains sufficient latitude with respect to an order executed by a CHX specialist acting as agent for the order,³ but does not contemplate any flexibility for specialists acting in their principal capacity.⁴ Accordingly, the Exchange obtained pilot approval of the attached rule change, which permits a CHX specialist, acting in their principal capacity, to manually execute an incoming market or marketable limit order in an Exempt ETF at a price other than the NBBO.⁵ The pilot is due to expire on December 24, 2004.⁶ Accordingly, the Exchange requests a sixty-day extension of the pilot rule

³ The Best Rule provision governing manual agency executions obligates the CHX specialist to seek “. . . the best *available* price.” CHX Article XX, Rule 37(a)(2).

⁴ The Best Rule provision governing manual principal executions obligates the CHX specialist to execute the order at the “. . . *NBBO price and size* at the time the order was received.” CHX Article XX, Rule 37(a)(2).

⁵ This rule change is closely analogous to the Exchange’s previously submitted interpretation regarding execution of resting limit orders in Exempt ETF. Under the limit order interpretation, CHX specialists need not provide execution guarantees for Exempt ETFs, based on trade-throughs by other markets, that CHX specialists typically provide to all other listed issues. *See* SEC Release No. 34-46557 (September 26, 2002), 67 FR 61941 (October 2, 2002).

⁶ *See* SEC Release No. 34-50590 (October 26, 2004), 69 FR 63419 (November 1, 2004).

change; the pilot rule text incorporated into this submission as Exhibit 5 does not differ in any respect from the existing pilot rule provisions.

Significantly, the pilot rule change does not excuse a CHX specialist from their best execution obligations with respect to manually-executed orders. Moreover, the pilot rule change only relates to orders that are executed manually, when a CHX specialist's ability to obtain liquidity at an exact NBBO price point is extremely limited. Orders that are executed automatically will continue to be executed by the Exchange's MAX® automated execution system at the NBBO in effect at the time the order is received.

- (b) The proposed rule change 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). In particular, the proposed rule change is consistent with Section 6(b)(5) of the Act in that it is designed to promote just and equitable principles of trade, to remove impediments 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.

Item 4. Self-Regulatory Organization's Statement of Burden on Competition

The Exchange believes that no burden will be placed on competition as a result of the proposed rule change.

Item 5. 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.

Item 6. Extension of the Time Period for Commission Action

The Exchange does not consent to an extension of the time period specified in Section 19(b)(2) of the Act.

Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The Exchange is submitting its request for extension of the pilot rule change under Section 19(b)(3)(A) of the Act and SEC Rule 19b-4(f)(6), as the Exchange believes that this non-controversial proposal does not significantly affect the

protection of investors or the public interest and does not impose any significant burden on competition. The Exchange respectfully requests that the Commission waive the 5-day pre-filing period and the 30-day operative delay period otherwise required under SEC Rule 19b-4(f)(6) and designate the proposal as both effective and operative upon filing with the Commission, so that the pilot may continue uninterrupted. The Exchange submits that uninterrupted effectiveness of the pilot rule change is consistent with the protection of investors and the public interest, satisfying the requirements of SEC Rule 19b-4(f)(6)(iii).

Item 8. Proposed Rule Change Based on Rule of Another Self-Regulatory Organization or of the Commission

The proposed rule is not based on the rules of other self-regulatory organizations or of the Commission.

Item 9. Exhibits

Attached as Exhibit A is the text of the proposed rule change.

Attached as Exhibit 1 is the form of Notice of the Proposed Rule Change for the Federal Register.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the self-regulatory organization has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

CHICAGO STOCK EXCHANGE,
INCORPORATED

By: _____
Kathleen M. Boege
Vice President
and Associate General Counsel

Exhibit 1**SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-____; File No. SR-CHX-2004-43)****Self-Regulatory Organizations; Chicago Stock Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Extension of Pilot Rule Change Relating to Transactions in Certain Exchange-Traded Funds**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 20, 2004, the Chicago Stock Exchange, Incorporated (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) a request for extension of a pilot rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Exchange filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act,³ and Rule 19b-4(f)(6)⁴ thereunder, which renders the rule change effective upon filing with the Commission.⁵ The Commission is publishing this notice to solicit comments on the interpretation from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

In its submission, the Exchange requested extension of a pilot rule change to CHX Article XX, Rule 37(a), which governs manual execution of eligible market and

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ The Commission waived the 5-day prefiling notice requirement.

marketable limit orders. The pilot rule change, which will remain in effect for an additional 60-day pilot period, permits a CHX specialist, acting in its principal capacity, to manually execute an incoming market or marketable limit order in one of three exchange-traded funds at a price other than the national best bid or offer.

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 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

On August 28, 2002, the Commission issued an order granting a *de minimis* exemption (the “Exemption”) for transactions in certain exchange-traded funds (“Exempt ETFs”)⁶ from the trade-through provisions of the Intermarket Trading System (“ITS”) Plan. *See* SEC Release No. 46428 (August 28, 2002).⁷

As stated by both Commission staff and commissioners at an open meeting on August 27, 2002, rapid-fire quotations and executions in Exempt ETFs occur consistently

⁶ The three affected Exempt ETFs are the exchange-traded funds tracking the Nasdaq-100 Index (“QQQ”), the Dow Jones Industrial Average (“DIAMONDS”) and the Standard & Poor’s 500 Index (“SPDRs”).

⁷ At present, the Exemption extends to transactions that are “executed at a price that is no more than three cents lower than the highest bid displayed in CQS and no more than three cents higher than the lowest offer displayed in CQS.”

throughout the trading day within a range around the NBBO, rendering it extremely difficult, if not impossible, to access liquidity at an exact NBBO price point. Compounding the “flickering” noted by the Commission, the Exchange has noted a marked increase in the incidence of locked and crossed markets in Exempt ETFs.

CHX Article XX, Rule 37(a), commonly referred to as the Exchange’s “Best Rule,” requires that with respect to any market or marketable limit order not executed automatically, a CHX specialist must “. . . either (a) manually execute such order at a price and size equal to the NBBO price and size the time the order was received; or (b) act as agent for such order in seeking to obtain the best available price for such order on a marketplace other than the Exchange, using order routing systems where appropriate.”

Given the unique environment in which the ETFs are traded, and the difficulty that CHX specialists often encounter in accessing NBBO price points, the Exchange’s Department of Market Regulation (the “Department”) believes that its enforcement of the Best Rule must take the ETF trading environment into account when the Department evaluates the execution prices of eligible market and marketable limit orders for Exempt ETFs. The Department believes that in certain instances, execution of an order in an Exempt ETF at a price other than the NBBO may nonetheless be consistent with the specialist’s best execution obligation, in light of the unique environment that characterizes trading in Exempt ETFs. The Exchange believes that the current version of the BEST Rule contains sufficient latitude with respect to an order executed by a CHX specialist acting as agent for the order,⁸ but does not contemplate any flexibility for

⁸ The Best Rule provision governing manual agency executions obligates the CHX specialist to seek “. . . the best *available* price.” CHX Article XX, Rule 37(a)(2).

specialists acting in their principal capacity.⁹ Accordingly, the Exchange obtained pilot approval of the attached rule change, which permits a CHX specialist, acting in their principal capacity, to manually execute an incoming market or marketable limit order in an Exempt ETF at a price other than the NBBO.¹⁰ The pilot is due to expire on December 24, 2004.¹¹ Accordingly, the Exchange requests a sixty-day extension of the pilot rule change; the pilot rule text incorporated into this submission as Exhibit 5 does not differ in any respect from the existing pilot rule provisions.

Significantly, the pilot rule change does not excuse a CHX specialist from their best execution obligations with respect to manually-executed orders. Moreover, the pilot rule change only relates to orders that are executed manually, when a CHX specialist's ability to obtain liquidity at an exact NBBO price point is extremely limited. Orders that are executed automatically will continue to be executed by the Exchange's MAX® automated execution system at the NBBO in effect at the time the order is received.

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,

⁹ The Best Rule provision governing manual principal executions obligates the CHX specialist to execute the order at the "... *NBBO price and size* at the time the order was received." CHX Article XX, Rule 37(a)(2).

¹⁰ This rule change is closely analogous to the Exchange's previously submitted interpretation regarding execution of resting limit orders in Exempt ETF. Under the limit order interpretation, CHX specialists need not provide execution guarantees for Exempt ETFs, based on trade-throughs by other markets, that CHX specialists typically provide to all other listed issues. *See* SEC Release No. 34-46557 (September 26, 2002), 67 FR 61941 (October 2, 2002).

¹¹ *See* SEC Release No. 34-50590 (October 26, 2004), 69 FR 63419 (November 1, 2004).

and, in particular, with the requirements of Section 6(b).¹² The CHX believes the proposal is consistent with Section 6(b)(5) of the Act¹³ in that it is designed to promote just and equitable principles of trade, to remove impediments, 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 of 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 Regarding 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 pilot 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 such shorter time as the Commission may designate,

it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁴ and Rule 19b-4(f)(6) thereunder.¹⁵ At any time during the 60-day pilot period, the Commission may

¹² 15 U.S.C. 78(f)(b).

¹³ 15 U.S.C. 78f(b)(5).

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 17 CFR 240.19b-4(f)(6).

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.

The Exchange has requested that the Commission accelerate the operative date. The Commission finds good cause to designate the proposal to become operative immediately because such designation is consistent with the protection of investors and the public interest. For these reasons, the Commission finds good cause to designate that the proposal is both effective and operative upon filing with the Commission.¹⁶

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, N.W., Washington D.C. 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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer

¹⁶ For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation.

to File No. SR-CHX-2004-43 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland
Deputy Secretary

¹⁷ 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Chicago Stock Exchange Rules

ARTICLE XX

**Guaranteed Execution System
and Midwest Automated Execution System**

RULE 37(a). Guaranteed Executions.

* * * * *

1. Eligible Orders. Specialists must accept and guarantee execution of all agency market and marketable limit orders from 100 through 5099 shares in accordance with this rule.

2. Market and Marketable Limit Orders. With respect to any market or marketable limit order not executed automatically, a specialist shall be obligated to either (a) manually execute such order at a price and size equal to or better than the NBBO price and size at the time the order was received (except for an order in an exchange-traded fund that tracks the Nasdaq-100 Index (“QQQ”), the Dow Jones Industrial Average (“DIAMONDS”) or the Standard & Poor’s 500 Index (“SPDRs”)); or (b) act as agent for such order in seeking to obtain the best available price for such order on a marketplace other than the Exchange, using order routing systems where appropriate. The specialist’s obligation shall always be subject to the requirements of the short sale rule. For purposes of this rule, “NBBO” shall mean, for Dual Trading System issues, the size and price associated with the best bid among the American, Boston, Cincinnati, Chicago, New York, Pacific, Philadelphia or the Intermarket Trading System/Computer Assisted Execution System (“ITS/CAES”) quote (“ITS Best Bid”) on a sell order or the price and size associated with the best offer among the American, Boston, Cincinnati, Chicago, New York, Pacific, Philadelphia or the ITS/CAES quote (“ITS Best Offer”) on a buy order (the “ITS Best Bid” and “ITS Best Offer” are collectively referred to as the “ITS BBO”). For NASDAQ/NM Securities, “NBBO” shall mean the price and size associated with the best bid disseminated pursuant to SEC Rule 11Ac1-1 on a sell order or price and size associated with the best offer disseminated pursuant to SEC Rule 11Ac1-1 on a buy order (collectively, the “NBBO”); or, if the specialist is quoting at the NBBO, the size associated with the specialist’s bid or offer and the auto-execution threshold designated by the specialist.