

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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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.

Form 19b-4 Information

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”), proposes to amend its rules to clarify the requirements of its priority rule and to require specialists to make use of Exchange-provided order match functionalities. The text of the proposed rule change is set out below.

Article XXX Specialists

* * *

Precedence to Orders in Book

RULE 2. a. The specialist, co-specialist and relief specialist shall at all times give precedence to orders in the book for purchase or sale of securities over the orders which originate with him or it as a dealer; provided his or its orders and those of his or its customer are market orders or limited orders at the same price. Notwithstanding the foregoing, whenever a specialist, co-specialist or relief specialist elects to accept a professional order for the book which is not required to be accepted by the such specialist, co-specialist or relief specialist pursuant to the rules and policies of the Exchange, such specialist, co-specialist or relief specialist is not required to relinquish precedence to such order over the orders which originate with him or it as a dealer, provided (a) his or its orders and those of his or its customer are limited orders at the same price and (b) the specialist, co-specialist or relief specialist is displaying his or its order, including its size, through the quotation system. No specialist, co-specialist or relief specialist may charge a member or member organization a commission in any transaction in which he or it is a principal.

b. Use of any and all exchange-provided order match functionality is mandatory, except in cases of systems problems with such functionality. “Order match functionality” is defined to mean any automated process by which a proposed specialist execution on a principal basis is replaced by the execution of an eligible customer order resident on the specialist’s book.

• • • ***Interpretations and Policies***

.01 No change to text.

.02 No change to text.

.03 No change to text.

.04. No change to text.

.05 No change to text.

.06 No change to text.

.07 If (1) a specialist seeks liquidity in a specialty stock in another market with respect to one or more orders in the book; and (2) while waiting for an execution report from the other market, the specialist executes the order(s) in the book pursuant to the preopening order guarantee set out in the Exchange's rules; and (3) the specialist then receives the execution report(s) from the other market at a price equal to the execution(s) given the orders pursuant to the preopening order guarantee, the specialist shall not be required to fill any other customer order(s) in his or its book as a result of having received the execution report from the other market.

2. **Procedures of Self-Regulatory Organization**

The Executive Committee of the Exchange's Board of Governors unanimously approved these proposed rule changes at a meeting on December 16, 2004.

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

(a) The Exchange's rules generally require CHX specialists to give precedence to orders in their books for the purchase or sale of securities over orders which originate with the specialists as dealers.¹ Although specialists are not required to yield precedence to professional orders in certain circumstances, they are not permitted to trade ahead of customer orders.²

¹ See Article XXX, Rule 2 ("Precedence to Orders in Book").

² If a specialist accepts a professional order for the book which it is not required to accept under the rules and policies of the Exchange, the specialist is not required to yield precedence to that order over its own principal interest if the specialist is displaying its interest through the quotation system.

The Exchange's systems incorporate several different order match functionalities that are designed to replace proposed specialist executions on a principal basis with executions of eligible customer orders in the specialist's book. These functionalities, among other things, prevent a specialist from manually executing an order on a principal basis when there is a customer order on the same side of the book that is eligible for execution.

The Exchange's specialist firms currently are using the CHX-provided order match functionalities that are available to them. This proposed rule change would require them to continue that use, except when there are system problems with the order match functionalities. The Exchange believes that this proposed rule would benefit investors by preventing potential trading ahead violations from occurring.

In addition, the current rule change proposal would add an interpretation to the Exchange's rules to clarify a specialist's obligation to yield precedence to orders when receiving execution reports from other markets at the opening of the CHX market. Specifically, the proposal would confirm that, (1) when a specialist has sought liquidity in a specialty stock in another market with respect to one or more orders in the book; and (2) while waiting for an execution report from the other market, the specialist has executed the order(s) in the book, as principal, pursuant to the preopening order guarantee set out in the Exchange's rules; and (3) the specialist then has received the execution report(s) from the other market at a price equal to the execution(s) given the orders pursuant to the preopening order guarantee, the specialist shall not be required to fill any other customer order(s) in its book as a result of having received the execution report from the other market. These situations may arise at the opening of the CHX market, in actively-traded stocks, where execution reports from other markets are received by the Exchange's specialists after the Exchange receives notice of a print or quote that triggers the execution of preopening orders in the CHX specialist book.³ In these situations, a specialist has executed preopening orders at the guaranteed price and then receives a later report that he has been executed in another market that same price. The Exchange believes that it is appropriate to clarify its precedence rule to confirm that, in these situations, a specialist should not be required to provide the execution it receives from another market to an order received after the Exchange's market opened.

(b) Approval of the rule changes proposed in this submission 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

³ Under CHX rules, the Exchange generally is open for trading during the hours that a stock trades in its primary market. See Article IX, Rule 10(b). The opening of the Exchange's market is triggered, in most instances, when the Exchange receives a trade report or quote from other markets. For example, the Exchange's specialists fill orders received before the opening ("preopening orders") in listed securities are filled at the primary market opening trading price. Preopening orders in Nasdaq/NM securities are filled at a single price that is at or better than the national best bid or offer at the first unlocked, uncrossed market that occurs on or after 8:30 a.m. to the extent that buy and sell orders offset each other.

requirements of Section 6(b). In particular, the proposed changes are consistent with Section 6(b)(5) of the Act, because they would promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national market system, and, in general, protect investors and the public interest by requiring CHX specialist firms to engage technology that would prevent improper order executions from occurring.

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 changes.

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.

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.

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

Not applicable.

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

The proposed rule change is not specifically based on the rules of other self-regulatory organizations or of the Commission, although many aspects of the proposal are substantially similar to an interpretation by the National Association of Securities Dealers of its Rule 2100. This interpretation, IM-2110-2(c), provides an exemption from the general prohibition against trading ahead of customer limit orders in situations where an NASD member has facilitated the execution of another customer order on a riskless principal basis.

9. Exhibits

Exhibit 1: The Completed Notice of the Proposed Rule Change for publication in the Federal Register.

Exhibits 2-5: Not applicable.

Exhibit 1

SECURITIES AND EXCHANGE COMMISSION

**(Release No. 34-____; File No. SR-CHX-2005-01)
SELF-REGULATORY ORGANIZATIONS**

Proposed Rule Change By The Chicago Stock Exchange, Incorporated Relating to Its Priority Rule and the Mandatory Use of Order Match Functionalities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”), 15 U.S.C. 78s(b)(1), notice is hereby given that on February 3, 2005, the Chicago Stock Exchange, Incorporated (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the CHX. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Chicago Stock Exchange, Incorporated (the “CHX” or the “Exchange”), pursuant to Rule 19b-4 of the Securities Exchange Act of 1934 (as amended, the “Act”), proposes to amend its rules to clarify the requirements of its priority rule and to require specialists to make use of Exchange-provided order match functionalities.

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 changes 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 Changes

1. Purpose

The Exchange's rules generally require CHX specialists to give precedence to orders in their books for the purchase or sale of securities over orders which originate with the specialists as dealers.¹ Although specialists are not required to yield precedence to professional orders in certain circumstances, they are not permitted to trade ahead of customer orders.²

The Exchange's systems incorporate several different order match functionalities that are designed to replace proposed specialist executions on a principal basis with executions of eligible customer orders in the specialist's book. These functionalities, among other things, prevent a specialist from manually executing an order on a principal basis when there is a customer order on the same side of the book that is eligible for execution.

The Exchange's specialist firms currently are using the CHX-provided order match functionalities that are available to them. This proposed rule change would require them to continue that use, except when there are system problems with the order match

¹ See Article XXX, Rule 2 ("Precedence to Orders in Book").

² If a specialist accepts a professional order for the book which it is not required to accept under the rules and policies of the Exchange, the specialist is not required to yield precedence to that order over its own principal interest if the specialist is displaying its interest through the quotation system.

functionalities. The Exchange believes that this proposed rule would benefit investors by preventing potential trading ahead violations from occurring.

In addition, the current rule change proposal would add an interpretation to the Exchange's rules to clarify a specialist's obligation to yield precedence to orders when receiving execution reports from other markets at the opening of the CHX market. Specifically, the proposal would confirm that, (1) when a specialist has sought liquidity in a specialty stock in another market with respect to one or more orders in the book; and (2) while waiting for an execution report from the other market, the specialist has executed the order(s) in the book, as principal, pursuant to the preopening order guarantee set out in the Exchange's rules; and (3) the specialist then has received the execution report(s) from the other market at a price equal to the execution(s) given the orders pursuant to the preopening order guarantee, the specialist shall not be required to fill any other customer order(s) in its book as a result of having received the execution report from the other market. These situations may arise at the opening of the CHX market, in actively-traded stocks, where execution reports from other markets are received by the Exchange's specialists after the Exchange receives notice of a print or quote that triggers the execution of preopening orders in the CHX specialist book.³ In these situations, a specialist has executed preopening orders at the guaranteed price and

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then receives a later report that he has been executed in another market that same price. The Exchange believes that it is appropriate to clarify its precedence rule to confirm that, in these situations, a specialist should not be required to provide the execution it receives from another market to an order received after the Exchange's market opened.

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).⁴ The CHX believes the proposal is consistent with Section 6(b)(5) of the Act⁵ 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. Indeed, the proposed mandatory use of Exchange-provided order match functionalities is specifically designed to protect investor interests. The proposed clarification of the priority rule is designed to confirm the scope of the priority rule, providing both investors and specialists with a more detailed understanding of a specialist's obligations.

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

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

⁴ 15 U.S.C. 78(f)(b).

⁵ 15 U.S.C. 78f(b)(5).

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

No written comments were either solicited or received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such other period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve the proposed rule changes, or

(B) institute proceedings to determine whether the proposed rule changes should be disapproved.

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.

Comments may be submitted by any of the following methods:

Electronic Comments:

· Use the Commission's Internet comment form

(<http://www.sec.gov/rules/sro.shtml>); or

· Send an e-mail to rule-comments@sec.gov. Please include File No. SR-CHX-2004-26 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File No. SR-CHX-2005-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 changes 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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-CHX-2005-01 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland
Deputy Secretary

⁶ 17 CFR 200.30-3(a)(12).