

quality statistics; thus, the CHX believes that "front-end" execution guarantees are no longer necessary to attract order flow. Accordingly, the Exchange believes that the guarantee no longer serves a clear competitive purpose. Secondly, since the securities industry converted to decimal trading, the availability of liquidity at a best bid or offer price has declined, making it difficult for the CHX specialist, who chooses to offset his positions in another market, to access liquidity at the price the rule requires him to provide. Consequently, the Exchange believes it is no longer appropriate to mandate that specialists guarantee execution of resting limit orders for listed issues based on activity in other market centers.

### III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>6</sup> and, in particular, the requirements of Section 6(b)(5) of the Act<sup>7</sup> because it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission agrees that the environment has changed significantly since the Exchange voluntarily enacted its rule-based execution guarantees, and that consequently, the guarantees may no longer serve to foster competition between the markets.

However, the Commission emphasizes that the deletion of the rule-based mandate regarding limit order protection does not in any way affect a CHX specialist's obligation to provide best execution, nor would it modify any other specialist obligations set forth in Article XXX of the CHX Rules. The Exchange must continue its surveillance of order executions to ensure that CHX specialists meet all of their obligations to each order. The Commission further emphasizes that, to the extent limit order protection guarantees are provided on a voluntary, issue-by-issue basis, such guarantees would have to be provided on a non-discriminatory basis.

<sup>6</sup> In approving this proposed rule change, as amended, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-CHX-2004-17), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Jonathan G. Katz,**  
*Secretary.*

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**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52647; File No. SR-CHX-2005-01]

### Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to the Exchange's Order Priority Rule and the Mandatory Use of Order Match Functionalities

October 21, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 3, 2005, the Chicago Stock Exchange, Inc. ("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. On September 16, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On October 6, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>4</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 Exchange Article XXX, Rule 2, Precedence to Orders in Book, to clarify the requirements of the Exchange's priority rule and to require specialists to

make use of Exchange-provided order match functionalities. The text of the proposed rule change is available on the Exchange's Web site ([http://www.chx.com/rules/proposed\\_rules.htm](http://www.chx.com/rules/proposed_rules.htm)), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

#### 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 Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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 Exchange's rules generally require Exchange specialists to give precedence to orders in their books for the purchase or sale of securities over orders that originate with the specialists as dealers.<sup>5</sup> Although specialists are not required to yield precedence to professional orders in certain circumstances, specialists are not permitted to trade ahead of customer orders.<sup>6</sup>

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

<sup>5</sup> See Exchange Article XXX, Rule 2, Precedence to Orders in Book.

<sup>6</sup> If a specialist accepts a professional order for the book that the specialist 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 the specialist's principal interest if the orders that originate from the specialist and its customer are limit orders at the same price and the specialist is displaying its interest through the quotation system. See Exchange Article XXX, Rule 2. Under the Exchange's rules, a "professional" order is an order for the account of a broker-dealer, the account of an associated person of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest. See Exchange Article XXX, Rule 2, Interpretations and Policy .04.

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Form 19b-4 dated September 16, 2005 ("Amendment No. 1). Amendment No. 1 replaced the original filing in its entirety.

<sup>4</sup> Amendment No. 2 was a partial amendment in which the Exchange corrected errors in the previously filed Exhibit 4. The Exhibit 4 included in Amendment No. 2 replaced the previously filed Exhibit 4 in its entirety.

order on the same side of the book that is eligible for execution.

The Exchange's specialist firms have confirmed to the Exchange that they desire to, and are, using the Exchange-provided order match functionalities that are available to them. The proposed rule change would require specialists to continue such use, except when there are system problems with the order match functionalities<sup>7</sup> or, when two specific types of exceptions arise. The Exchange believes that the proposed rule change would benefit investors by preventing potential trading ahead violations from occurring.

The two exceptions to the general rule requiring use of order match functionalities are relatively narrow. First, 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 Exchange 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 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 its book as a result of having received the execution report from the other market. These situations may arise at the opening of the Exchange market, in actively-traded stocks, when the Exchange's specialists receive execution reports from other markets after the Exchange receives notice of a print or quote that triggers the execution of preopening orders in the Exchange's specialist book.<sup>8</sup> In these situations, a

<sup>7</sup> The Exchange does not anticipate that systems problems will occur frequently, but has included this exception to the rule to address those relatively rare circumstances when the order match functionality is not operating properly due to unexpected consequences of unrelated systems changes or a software failure. This exception is not intended to allow participants to avoid the use of order match functionalities, but to recognize that there could be limited circumstances when the order match functionalities are malfunctioning. The Exchange anticipates that it would work quickly to correct any software or systems problems that prevented the use of the order match functionalities.

<sup>8</sup> Under Exchange rules, the Exchange generally is open for trading during the hours that a stock trades in its primary market. See Exchange Article IX, Rule

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 such 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.

Additionally, the Exchange believes that when an Exchange specialist either (1) received an inbound ITS execution in satisfaction of another market center's trade-through of the Exchange's bid or offer (and the specialist has already filled the customer order(s) that constituted the bid or offer traded through); or (2) received an inbound ITS execution in satisfaction of a complaint lodged by an Exchange specialist against another market center, the specialist would not be required to fill any other customer order(s) in his or its book as a result of having received the "satisfying" ITS execution.<sup>9</sup>

## 2. Statutory Basis

The Exchange 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) of the Act.<sup>10</sup> The Exchange believes the proposal is consistent with Section 6(b)(5) of the Act<sup>11</sup> because the proposal is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange believes that 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

<sup>10</sup>(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 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.

<sup>9</sup> See Exchange Article XXX, Rule 2, proposed Interpretations and Policy .08.

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

detailed understanding of a specialist's obligations.

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

The Exchange does not believe that the proposed rule change will impose any 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 solicited or received.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer 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 Exchange consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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](mailto:rule-comments@sec.gov). Please include File Number SR-CHX-2005-01 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number 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 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 the filing also will be available for inspection and copying at the principal office of the Exchange. 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 Number SR-CHX-2005-01 and should be submitted on or before November 18, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52655; File No. SR-FICC-2005-15]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Charges for Communications Fees To Continue Operating Legacy Communication Networks

October 24, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on September 9, 2005, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by FICC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The proposed rule change would revise the fees charged to members that fail to migrate their communications systems from legacy networks to The Depository Trust & Clearing Corporation's ("DTCC's") Securely Managed and Reliable Technology ("SMART") system<sup>2</sup> or to the Securities Industry Automation Corporation's ("SIAC's") Secure Financial Transaction Infrastructure ("SFTI") networks.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FICC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FICC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>3</sup>

##### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Beginning in 2003, FICC has periodically informed members of the need to migrate their telecommunications connectivity from SIAC's legacy based Broker and Access networks to DTCC's SMART system or SIAC's SFTI.<sup>4</sup> While several advantages exist in having all members successfully migrate, FICC's main objective in insourcing these services into its own data processing operations is to provide consistent business continuity planning capabilities across all FICC services. In the event of a large-scale regional disruption, any member accessing FICC through a legacy network will not have the benefits provided by the other communications vehicles which could create exposure to these members and their counterparties.<sup>5</sup>

<sup>2</sup> SMART is DTCC's centralized, end-to-end managed communications infrastructure that provides connectivity support for all post-trade clearance and settlement processing. Most of the services offered by DTCC's subsidiaries, The Depository Trust Company, the National Securities Clearing Corporation, and FICC are accessible through SMART. SMART is interoperable with SFTI.

<sup>3</sup> The Commission has modified the text of the summaries prepared by FICC.

<sup>4</sup> DTCC Important Notices Z#0008, Z#0009, and Z#0010.

<sup>5</sup> SMART is designed to withstand catastrophic disaster scenarios and is set up to operate in DTCC's

While most FICC members have complied with stated migration requirements, several members continue to access FICC through legacy networks, which is imposing significant unnecessary costs on FICC for continued support of these systems. In order to encourage these members to migrate and in order to equitably allocate costs among its members, FICC intends to allocate its costs for continued support of legacy networks among the members using such systems on a pro rata basis. FICC plans to soon issue an important notice to members specifying the date such fees will become effective.<sup>6</sup>

In order to avoid bearing these costs, members currently using legacy systems are required to take the following actions: (i) As soon as possible, ensure adequate communications connectivity through SMART and/or SFTI, (ii) successfully complete testing through the newly-established pathways, (iii) complete full conversion of all input/output for applicable FICC applications directly to/from FICC through SMART and/or SFTI, and (iv) cancel the legacy network connections.

The proposed change is consistent with Section 17A of the Act<sup>7</sup> and the rules and regulations thereunder applicable to FICC because it will enable FICC to equitably allocate costs among its members.

##### (B) Self-Regulatory Organization's Statement on Burden on Competition

FICC does not believe that the proposed rule change will have any impact or impose any burden on competition.

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

Written comments relating to the proposed rule change have not yet been solicited or received. FICC will notify the Commission of any written comments received by FICC.

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

The foregoing rule change has become effective upon filing pursuant to Section

multiple remote sites to ensure its operability in the event of disruption. Legacy network connections are not automatically configured to "fail over" to DTCC's remote processing sites and therefore do not provide members using these networks with the resilience that would be needed in the event of a large-scale regional disruption.

<sup>6</sup> FICC expects that the migration deadline will be set for the end of 2005.

<sup>7</sup> 15 U.S.C. 78q-1.

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).