UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

March 16, 2006

Howard L. Kramer
Schiff Hardin LLP
1101 Connecticut Avenue, N.W., Suite 600
Washington, DC 20036

Re: Interpretive Guidance on the Limit Order Display Rule

Dear Mr. Kramer:

I am responding to your letter dated January 23, 2006 on behalf of your client, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange"). In your letter, you requested that the Division of Market Regulation ("Division") provide you with interpretive guidance regarding whether it is permissible under Rule 604 of Regulation NMS[1] ("Limit Order Display Rule") under the Securities Exchange Act of 1934 ("Exchange Act") for an exchange specialist or OTC market maker to send a portion of a customer limit order required to be displayed under the Limit Order Display Rule to one or more "market centers" that comply with the rule, and display the remainder of the order in its own quote.[2] You also requested that the Division provide you with interpretive guidance regarding whether it is permissible for an exchange specialist or OTC market maker to send the full size of a customer limit order required to be displayed under the Limit Order Display Rule to multiple away market centers that comply with the rule such that the full size of the customer limit order is displayed at the away market centers.

The Limit Order Display Rule requires exchange specialists and OTC market makers to immediately display in their bid or offer both the price and the full size of each customer limit order that would improve their quoted price in a particular security. In addition, the rule requires that exchange specialists and OTC market makers who have a bid or offer that is equal to the national best bid or offer to reflect in their quote the size of a customer limit order that is priced equal to that bid or offer and represents more than a de minimis change in their quotation size. The Limit Order Display Rule provides several exceptions to the display requirement, including an exception that permits an exchange specialist or OTC market

1 17 CFR 242.604.

2 Rule 600(b)(38) of Regulation NMS defines a "market center" as any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association. 17 CFR 242.600(b)(38).

maker to deliver a customer limit order immediately upon receipt to an exchange or association-sponsored system, or an electronic communications network (ECN) that complies with the requirements of Rule 602(b)(5)(ii), rather than display the order in its own quote.[3] In addition, the rule provides an exception that permits an exchange specialist or OTC market maker to deliver a customer limit order immediately upon receipt to another exchange specialist or OTC market maker that complies with the requirements of the rule, rather than display the order in its own quote.[4]

In 1996, shortly after the Commission adopted the Limit Order Display Rule, the Division provided interpretive guidance on whether an exchange specialist or OTC market maker could send a portion of a customer limit order to another market center that complies with the Limit Order Display Rule and display the remainder of the order in its own quote. At that time, the Division stated that an exchange specialist or OTC market maker should either display the full size of the order in its own quote or send it to a market center where the order will be fully displayed.[5] In reaching this conclusion, the Division noted the Commission's statement in the release that adopted, among other things, the Limit Order Display Rule,[6] that the display of full size not only improves transparency, but also is a factor in attracting order flow, thereby increasing the likelihood that a limit order will be executed.

The Division believes that, in light of developments in the national market system since the Commission adopted the Limit Order Display Rule in 1996, a more flexible interpretation is warranted. In particular, technological developments have allowed market participants to quickly and efficiently access multiple market centers when executing an order, and both regulatory and technological changes have increased the transparency of customer limit orders. These developments help to ensure that, irrespective of whether a limit order is displayed at one market center or multiple market centers that comply with the rule, the order will, in the aggregate, effectively be displayed in full and that interested market participants will be able to readily access the full size of the order, even if it is located in multiple market centers.

Accordingly, the Division believes that, consistent with the Limit Order Display Rule: (1) an exchange specialist or OTC market maker may immediately send a portion of a customer limit order required to be displayed under the rule to one or more away market centers that comply with the rule, and immediately display the remainder of the order in its own quote; and (2) an exchange specialist or OTC market maker may immediately send the full size of a customer limit order required to be displayed under the rule to multiple away

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3 17 CFR 242.604(b)(5).

4 17 CFR 242.604(b)(6).

5 See Letter from Richard R. Lindsey, Director, Division, Commission, to Richard Grasso, Chairman and Chief Executive Officer, New York Stock Exchange (November 22, 1996) (providing interpretive guidance on the order execution rules).

6 See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).

market centers that comply with the rule such that the full size of the customer limit order is displayed at the away market centers.

The views contained herein represent the views of the staff of the Division. If you have any questions regarding this letter, please do not hesitate to contact me.

Sincerely,

Robert Colby

Robert L.D. Colby
Acting Director

SCHIFF HARDIN LLP
A Limited Liability Partnership Including Professional Corporations

1101 Connecticut Avenue, N.W., Suite 600
Washington, DC 20036
t 202.778.6400
f 202.778.6460
www.schiffhardin.com

Howard Kramer
202.778.6414
hkramer@schiffhardin.com

January 23, 2006

David Shillman
Associate Director
Division of Market Regulation
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request Regarding the Limit Order Display Rule

Dear Mr. Shillman,

We are writing to you on behalf of our client, the Chicago Stock Exchange, Inc. ("CHX"), to request interpretative guidance with respect to Rule 604 of Regulation NMS (the "Limit Order Display Rule") under the Securities Exchange Act of 1934 ("Exchange Act"). In particular, the CHX requests that the Division of Market Regulation ("Division") permit an exchange specialist or OTC market maker to send a portion of a customer limit order required to be displayed under the Limit Order Display Rule to one or more "market centers" that comply with the rule and to display the remainder of the order in its own quote.[1] The CHX also requests that the Division permit an exchange specialist or OTC market maker to send the full size of a customer limit order required to be displayed under the rule to multiple away market centers that comply with the rule such that the full size of the customer limit order is displayed at the away market centers. The basis for our request is set forth below.

1 Rule 600(b)(38) of Regulation NMS defines a "market center" as any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association. 17 CFR 242.600(b)(38).

I. Background

The Limit Order Display Rule requires exchange specialists and OTC market makers to immediately display in their bid or offer both the price and the full size of each customer limit order that would improve their quoted price in a particular security. In addition, the rule requires that exchange specialists and OTC market makers who have a bid or offer that is equal to the national best bid or offer to reflect in their quote the size of a customer limit order that is priced equal to that bid or offer and represents more than a *de minimis* change in their quotation size. The Limit Order Display Rule provides several exceptions to the display requirement, including an exception that permits an exchange specialist or OTC market maker to deliver a customer limit order to an exchange or association sponsored system or an electronic communications network ("ECN"), rather than display the order in its own quote.[2] In addition, the rule provides an exception that permits an exchange specialist or OTC market maker to deliver a customer limit order to another exchange specialist or OTC market maker that complies with the requirements of the rule rather than display the order in its own quote.[3]

Shortly after the adoption of the Limit Order Display Rule in 1996, the Division responded to an interpretative question seeking guidance on whether an exchange specialist or OTC market maker can send a portion of a customer limit order to another market center that complies with the Limit Order Display Rule and display the remainder of the order in its own quote. In its response, the Division noted that the Limit Order Display Rule requires that a customer limit order be displayed in full.[4] The Division also noted that the Commission stated in the adopting release for the Limit Order Display Rule that the display of full size not only improves transparency, but also is a factor in attracting order flow and increases the likelihood that a limit order will be executed.[5] The Division therefore took the position that an exchange specialist or OTC market maker should either display the full size of the order in its own quote or send it to a market center where the order will be fully displayed.

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2 Rule 604(b)(5) of Regulation NMS, 17 CFR 242.604(b)(5).

3 Rule 604(b)(6) of Regulation NMS, 17 CFR 242.604(b)(6).

4 See Letter re: Interpretive Guidance on the Order Execution Rules (Nov. 22, 1996).

5 See Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290 (Sept. 12, 1996).

II. Discussion

CHX believes that exchange specialists and OTC market makers who receive customer limit orders required to be displayed under the Limit Order Display Rule should be permitted to send portions of those orders to other market centers that comply with the Limit Order Display Rule and to display the remainder of those orders in their own quotes. Similarly, CHX believes that exchange specialists and OTC market makers who receive customer limit orders required to be displayed under the Limit Order Display Rule should be permitted to send the full size of the customer limit orders to multiple away market centers that comply with the rule. As noted above, the Division has previously taken the position that an exchange specialist or OTC market maker should either display the full size of the order in its own quote or send it to a market center where the order will be fully displayed. CHX believes, however, that the Division should revisit and modify its prior position for the reasons set forth below.

We initially note that the language of the rule does not expressly prohibit an exchange specialist or OTC market maker from sending a portion of an order required to be displayed under the rule to another market center. In particular, although the rule requires an exchange specialist or OTC market maker to display "the price and full size of each customer limit order" that improves its bid or offer and to display "the full size of each customer limit order" that increases the size of its quote at the national best bid or offer by more than a *de minimis* amount, the rule provides an exception for "any customer limit order" that "is delivered immediately upon receipt" to another market center that complies with the requirements of the rule "with respect to that order." While the rule clearly requires the display of the full size of customer limit orders in certain circumstances, the rule also provides flexibility to exchange specialists and OTC market makers in accomplishing this requirement by allowing them to send orders to other market centers that comply with the rule. In this regard, we believe that the situation in which an exchange specialist or OTC market maker sends an entire order to another market center and the situation in which an exchange specialist or OTC market maker sends a portion of an order to one or more market centers that comply with the rule and displays the remainder of the order in its quote are indistinguishable because the full size of the customer limit order is eligible for display in either case. We therefore believe an exchange specialist or OTC market maker who sends a portion of a customer limit order to one or more market centers that comply with the rule and displays the remainder in its quote would be acting in manner consistent with the rule.

There are valid reasons why an exchange specialist or OTC market maker may want to send part of a customer limit order to one or more market centers. For example, a CHX specialist might receive a customer limit order and want to send a portion of the order to the primary market for that security. By sending a "marker" order to the primary market, the CHX specialist can determine when the limit order would have been executed had it been sent directly to the primary market. Similarly, a specialist may do this by sending "marker orders" to both the primary market and a secondary market with significant volume in that security. Upon the execution at the primary market (or the secondary market in the case where the specialist sends "marker" orders to the primary and secondary markets), the CHX specialist could decide to execute the remainder of the order residing at the CHX. The Division's prior interpretation, however, would impede this procedure because it could result in a double execution if the limit order is hit for its full size at the CHX at the time of the primary market execution (or secondary market execution) but before the CHX specialist can reduce the CHX quote to reflect that execution. To prevent the possibility of a double execution, the CHX specialist would either have to send the full limit order to the primary market (or secondary market) or refrain from sending any portion away. Such a result can impede market making and the willingness of specialists to accept larger limit orders.

Similarly, there are valid reasons why an exchange specialist or OTC market maker may want to submit the full size of a customer limit order among multiple away market centers. For example, a CHX specialist may receive a large limit order required to be displayed under the rule in a stock where two market centers have a significant amount of the volume in that stock. The specialist may determine that the order will have a greater likelihood of being executed if a portion of the order is sent to one market center and the remainder of the order is sent to the other market center. The Division's prior interpretation, however, would prevent this procedure because the specialist would be required to sent the full size of the customer limit order to one market center or the other. Like the situation discussed above, this result can impede market making and the willingness of specialists to accept larger limit orders.

In addition, at the time the Division issued its original interpretive position discussed above, the Commission had recently adopted the Limit Order Display Rule and was still in the process of implementing the rule and addressing interpretive questions. More than nine years have passed since that time. The market structure changes that have occurred since the adoption of the Limit Order Display Rule have greatly increased the transparency of customer limit orders and the chances that these orders will interact with other orders and thus be executed. For example, Regulation ATS has significantly increased the transparency of customer limit orders and the interaction of these orders with other types of orders by requiring, among other things, that orders in a security in an alternative trading system with 5 percent or more of the volume in that security be accessible by the public markets. Moreover, Rule 610 of Regulation NMS (the "Access Rule") will allow more market participants to interact with customer limit orders by generally requiring fair access to trading centers. In addition, Rule 611 of Regulation NMS (the "Order Protection Rule") will help ensure that better-priced customer limit orders displayed at other market centers are executed by requiring that trading centers not trade-through better bids or offers at other trading centers. We therefore believe that these changes address the concerns expressed by the Division in its interpretative position by improving the transparency of customer limit orders and greatly increasing the likelihood that these orders will be executed.

Finally, since 1996 the equity markets have converted fully to decimal pricing and penny increments. As a result of a penny pricing increment, liquidity is thinner at the top of the limit order book and spread over more price points. It is far less meaningful in a pennies environment to require display of the full size of an order in a single market center's quote as opposed to allowing a limit order to be split among multiple market center's quotations.

III. Conclusion

For the foregoing reasons, we believe that an exchange specialist or OTC market maker should be permitted, consistent with the Limit Order Display Rule, to send portion of a customer limit order required to be displayed under the rule to one or more market centers that comply with the rule and to display the remainder of the order in its own quote. We also believe that an exchange specialist or OTC market maker should be permitted to send the full size of a customer limit order required to be displayed under the rule to multiple away market centers that comply with the rule such that the full size of the customer limit order is displayed at the away market centers. We are requesting interpretative guidance with respect to the above.

We appreciate your consideration of this request. If you have any questions regarding anything in this letter, please do not hesitate to contact me directly at (202) 778-6414.

Sincerely,

Howard L. Kramer

Howard L. Kramer

cc: Ellen Neely, CHX