

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47152; File No. SR-CHX-2001-33]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 by The Chicago Stock Exchange, Inc., Relating to Cancellation of Orders Otherwise Eligible for Automatic Execution

January 10, 2003.

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 December 26, 2001, 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 August 15, 2002, the CHX amended the proposal.<sup>3</sup> On January 9, 2003, the CHX again amended 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 CHX Article XX, Rule 37, which governs, among other things, cancellation of market and marketable limit orders that otherwise are eligible for automatic execution. The text of the proposed rule change is below. Additions are in italics.

#### Article XX

Guaranteed Execution System and Midwest Automated Execution System Rule 37

\* \* \* \* \*

(b) Automated Executions. The Exchange's Midwest Automated

Execution System (the MAX System) may be used to provide an automated delivery and execution facility for orders that are eligible for execution under the Exchange's BEST Rule (Article XX, Rule 37(a)) and certain other orders. In the event that an order that is subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the BEST Rule and the following. In the event that an order that is not subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the following:

(1)-(3) No change in text.

(4) Cancels. MAX will automatically cancel an unexecuted order in the file in the event an order sending firm inputs the proper cancellation instruction (*and not less than five (5) seconds has expired since receipt of the order*), except for an order on hold, a professional order or an oversized order. These orders must be canceled manually. For purposes of this subsection (4), oversized order means an order greater than the auto-execution threshold.

\* \* \* \* \*

#### 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 proposes to amend Article XX, Rule 37 of the CHX Rules, which governs, among other things, automatic execution of market and marketable limit orders that otherwise would be eligible for automatic execution. The proposed rule change is intended to provide CHX specialists and order-sending firms with further clarity regarding cancellation of orders.<sup>5</sup>

<sup>5</sup> The CHX initially filed this proposed rule change on December 26, 2001. After discussions with Commission staff, the CHX submitted Amendment No. 1, which replaces the original submission in its entirety. The only change is a

Under the current rule, if an order-sending firm does not receive an immediate execution, the order-sending firm may cancel the order, even though the order is not erroneous in any respect. In the interim between receipt and cancellation, however, the specialist may be actively managing the order and seeking liquidity to fill the order. This can lead to unintended (and unfair) results, including the possibility that the CHX specialist has made an ITS commitment to procure liquidity, which the order-sending firm no longer wants.

By implementing the proposed rule change, which would require that an order reside at the CHX for 5 seconds before a cancellation request will become effective (unless the specialist manually intervenes to cancel the order sooner), CHX specialists would be protected from the foregoing scenario. Significantly, order-sending firms that have entered an order that is truly erroneous may still cancel and resend such orders, using the "cancel/error" function. Accordingly, order-sending firms remain protected from adverse consequences in the case of truly erroneous orders.

###### 2. Statutory Basis

The Exchange believes that 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. In particular, the Exchange believes the proposed rule change is consistent with Section 6(b) of the Act.<sup>6</sup> The CHX believes the proposal is consistent with Section 6(b)(5) of the Act,<sup>7</sup> 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 on Burden on Competition

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

reduction of the proposed minimum order life from 15 seconds to five seconds. The submission also further details (a) the protections still afforded order-sending firms with legitimate cancellation needs, and (b) the initiatives by other exchanges to deter abuses of the order cancellation process, which have been approved by the Commission in recent months.

<sup>6</sup> 15 U.S.C. 78f(b).

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

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

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

<sup>3</sup> See August 13, 2002 letter from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, and attachments ("Amendment No. 1"). In Amendment No. 1, the CHX reduced the proposed minimum order life from 15 seconds to five seconds. Amendment No. 1 completely replaces and supersedes the original filing.

<sup>4</sup> See January 8, 2003 letter from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, and attachments ("Amendment No. 2"). In Amendment No. 2, the CHX provided a new Exhibit A to the proposed rule change that properly underscores language that is being added.

*C. Self-Regulatory Organization's Statement on Comments on 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**

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 CHX consents, the Commission will:

A. By order approve such 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 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 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 to File No. SR-CHX-2001-33 and should be submitted by February 6, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-47150; File No. SR-NFA-2002-06]

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Futures Association Concerning Delivery of the Risk Disclosure Statement for Security Futures Contracts by Commodity Trading Advisors**

January 9, 2003.

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-7 under the Act,<sup>2</sup> notice is hereby given that on November 29, 2002, the National Futures Association ("NFA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule changes described in Items I, II, and III below, which Items have been prepared by the NFA. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons. NFA also has filed the proposed rule change with the Commodity Futures Trading Commission ("CFTC").

On November 27, 2002, NFA requested that the CFTC make a determination that review of the proposed rule change is not necessary. The CFTC made such a determination on December 9, 2002.

**I. Self-Regulatory Organization's Description of the Proposed Rule Change**

Section 15A(k) of the Act<sup>3</sup> makes NFA a national securities association for the limited purpose of regulating the activities of members who are registered as brokers or dealers in security futures products under Section 15(b)(11) of the Act.<sup>4</sup> Where security futures accounts are solicited by commodity trading advisors (CTAs), the proposed rule changes shift responsibility for providing the risk disclosure for those products from the CTA to the firms carrying the account, which could be a broker-dealer registered under Section 15(b)(11).

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

NFA has prepared statements concerning the purpose of, and basis for,

the proposed rule change, burdens on competition, and comments received from members, participants, and others. The text of these statements may be examined at the places specified in Item IV below. These statements are set forth in Sections A, B, and C below.

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

1. Purpose

The Managed Funds Association (MFA) recently raised an issue regarding the security futures risk disclosure statement. The Commodity Futures Modernization Act of 2000 provides that, with respect to security futures products, CTAs, as well as other registrants, must be subject to suitability rules comparable to those that apply to NASD members. The "Know Your Customer" requirements in NFA Compliance Rule 2-30 include the requirement to provide appropriate risk disclosure, so when that rule was amended to include suitability requirements for security futures products, CTAs were included in the provisions of that rule relating to the disclosure statement. As Compliance Rule 2-30 and the related Interpretive Notice currently read, a CTA is required to provide the disclosure statement to the customer in the relatively rare instance where the CTA is the Member soliciting the account.

MFA has questioned this requirement for CTAs, pointing out that investment advisers have no similar requirement. Although someone must provide the disclosure statement to the customer, the Board agrees that the CTA does not have to be the source of that document. In fact, if the account is carried by an NASD member that is itself required by NASD rules to provide the document, NFA's current rule could result in both the CTA and the Futures Commission Merchant (FCM) delivering the document. Therefore, the Board amended NFA Compliance Rule 2-30 and the related Interpretive Notice to remove CTAs from the special risk disclosure requirements for security futures products and to place the obligation to provide the statement on the Member carrying an account solicited by the CTA. The CTA must still, of course, consider how well a customer understands the risks when determining if it is appropriate for the customer to trade security futures products or to use the CTA's trading program for that purpose.

<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 17 CFR 240.19b-7.

<sup>3</sup> 15 U.S.C. 78o-3(k).

<sup>4</sup> 15 U.S.C. 78o(b)(11).

<sup>8</sup> 17 CFR 200.30-3(a)(12).