

thereunder,² to add an alternative to the current procedures that apply to the assignment of orders on the Exchange's Retail Automatic Execution System ("RAES") to CBOE market-makers logged on to participate in RAES. The proposed rule change was published for comment in the **Federal Register** on May 18, 2005.³ The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

CBOE Rule 6.8 governs the execution of orders on RAES. CBOE Rule 6.8.06 sets forth alternatives available to the appropriate Floor Procedure Committee to implement the procedures for the assignment of RAES-eligible orders to CBOE market-makers logged onto RAES for execution. One alternative set forth in current Rule 6.8.06(c), the "100 Spoke RAES Wheel," assigns RAES orders to logged-in market-makers based on the percentage of their in-person agency contracts traded in that class (excluding RAES contracts traded) compared to all of the market-maker in-person agency contracts traded (excluding RAES contracts) during the review period. The proposed rule change sets forth a new alternative, available only in index option classes, that offers a wheel with 1000 spokes and assignment procedures that are similar to the assignment procedures applicable to the 100 Spoke RAES Wheel.

Under the proposed 1000 Spoke RAES Wheel, the appropriate Floor Procedure Committee will determine on a class-by-class basis whether the assignment of RAES orders to logged-in market-makers is based on the percentage of a market-maker's contracts traded in that index option class (excluding RAES contracts traded) compared to all market-maker contracts traded (excluding RAES contracts) during the review period, or the percentage of the market-maker's in-person agency contracts traded in that class (excluding RAES contracts traded) compared to all market-maker in-person agency contracts traded (excluding RAES contracts) during the review period. As is the case with the 100 Spoke RAES Wheel, the procedure for the 1000 Spoke RAES Wheel would provide that on each revolution of the wheel, each participating market-maker who is logged in RAES at the time will be assigned a number of contracts that approximates the percentage of

contracts on RAES that the market-maker traded in-person in that index option class during the review period, subject to the restrictions set forth in current Rule 6.8.06(c).

The effect of utilizing the 1000 Spoke RAES Wheel instead of the 100 Spoke RAES Wheel is that the number of contracts allocated to a market-maker will increase by a factor of 10 for every revolution of the RAES wheel. This procedure is designed to reduce the rounding effects that result under the 100 Spoke RAES Wheel (the RAES system configuration rounds contracts to the nearest whole number).

III. Discussion

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b) of the Exchange Act⁴ and the rules and regulations thereunder applicable to a national securities exchange.⁵ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act,⁶ which requires, among other things, that the Exchange's rules be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

The Commission believes that the proposal to add the alternative of the 1000 Spoke RAES Wheel would provide the Exchange with a greater degree of flexibility in allocating index option contracts that are executed automatically through RAES. The Exchange initially developed the 100 Spoke RAES Wheel as a means to allocate contracts executed through RAES according to the liquidity each market-maker provided on the floor. The Exchange asserted in its proposal, however, that the Floor Procedure Committees for index options have not employed the 100 Spoke RAES Wheel alternative because of the effects of rounding of that allocation method in larger trading crowds. The Commission believes that, with the 1000 Spoke RAES Wheel alternative, market-makers in index options would have a greater incentive to compete effectively for orders, and this, in turn, should benefit investors and promote the public interest.

The Commission notes that implementation of the 1000 Spoke

RAES Wheel, as with the 100 Spoke RAES Wheel, will have no effect on the prices offered to customers. Under CBOE Rule 6.8(d)(i), RAES automatically provides to each retail customer order an execution price, generally determined by the prevailing market quote at the time of the order's entry into the system. The 1000 Spoke RAES Wheel simply provides for another method of contract allocation in the case of index option contracts automatically executed through RAES.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,⁷ that the proposed rule change (SR-CBOE-2005-24) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

J. Lynn Taylor,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51997; File No. SR-CHX-2004-17]

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto To Amend Article XX, Rule 37(a)(3) of Its Rules To Eliminate Its Requirement That Specialists Guarantee Execution of Limit Orders When Certain Conditions Occur in Another Market

July 8, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 21, 2004, 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 CHX. On July 5, 2005, the Exchange filed an amendment to the proposed rule change.³ The Commission is publishing this notice to solicit

¹ 15 U.S.C. 78s(b)(2).

² 17 CFR 200.30-3(a)(12).

³ 15 U.S.C. 78s(b)(1).

⁴ 17 CFR 240.19b-4.

⁵ See Amendment No. 1 dated July 5, 2005, replacing the original filing in its entirety. In Amendment No. 1, the Exchange modified the text of the proposed rule change and the discussion in response to comments by the Commission staff.

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 51684 (May 11, 2005), 70 FR 28588.

⁴ 15 U.S.C. 78f(b).

⁵ In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f(b)(5).

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(a)(3), which provides for execution of resting CHX limit orders based on activity in other markets, to permit, but not require, CHX specialists to guarantee execution of such limit orders when certain conditions occur in another market. The text of the proposed rule change, as amended, is available on CHX's Web site (http://www.chx.com/marketreg/proposed_rules.htm), at CHX's principal office, 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 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 Changes

1. Purpose

The Exchange proposes to amend Article XX, Rule 37(a) of the CHX Rules, which provides for execution of resting CHX limit orders based on activity in other markets. The proposed rule change would permit, but not require, CHX specialists to guarantee execution of such limit orders when certain conditions occur in another market.

Background

CHX Article XX, Rule 37(a)(3) sets out specific execution guarantees for eligible limit orders. For listed issues, the rule generally obligates a CHX specialist to guarantee execution of limit orders resting in the specialist's book, when the issue is being traded in the primary market at a price equal to or better than the limit price. For NASDAQ/NM securities, the rule permits, but does not require, a CHX specialist to guarantee execution of limit orders resting in the specialist's book, when another market center's quotation locks or crosses the limit price.

The guarantees set forth in CHX Article XX, Rule 37(a)(3), commonly referred to as "limit order protection" or "primary market protection," were adopted voluntarily by the CHX over 15 years ago, as a means of attracting order flow. As noted by the Commission, the Exchange's initiatives relating to primary market protection were intended to ensure " * * * fair competition among exchange markets, which benefits public investors."⁴

Industry Changes Since Adoption of the Execution Guarantees

As our industry has evolved, the Exchange's principal competitors for order flow, namely "third market" execution venues and alternative trading systems, do not provide such limit order protection guarantees. Accordingly, the Exchange believes that the guarantees no longer serve a clear competitive purpose. This is particularly the case in recent years, since CHX order-sending firms now have free access to comprehensive monthly order execution quality statistics, rendering "front-end" execution guarantees unnecessary as a means of attracting order flow. Firms are able to closely monitor execution quality and, thereby, ensure that they are meeting their best execution obligations, without relying on rule-based guarantees.⁵

Compounding the lack of competitive value, the guarantees currently subject CHX specialists to exposure that was never intended when the rule-based guarantees were enacted. Since the securities industry conversion to decimal trading, the availability of liquidity at a best bid or offer ("BBO") price point has declined, in many cases significantly. The CHX specialist, if he chooses to offset his positions in

⁴ See Securities Exchange Act Release No. 32124 (April 13, 1993), 58 FR 21325 (April 20, 1993). The Exchange believes that other regional exchanges have enacted similar rule-based guarantees. See, e.g., BSE Chapter II, Section 33, Interpretation and Policy .01, NSX Rule 11.9, and Phlx Rule 229. The Exchange believes that the rule-based guarantees were enacted on a strictly voluntary basis and were not required by the Act or by any requirement promulgated by Congress or the Commission in accordance with the Act, including the Order Handling Rules issued by the Commission in 1996. See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996). The standards for execution of limit orders set forth in the Order Handling Rules do not require that best execution be measured on an order-by-order basis. Rather, they contemplate evaluation using aggregate standards.

⁵ The Exchange notes the dramatic increase in market share that has been achieved by several of the Exchange's third market competitors as evidence that order-sending firms no longer consider rule-based execution guarantees essential to their order-routing decisions, or presumably to satisfaction of their best execution obligations.

another market, often encounters great difficulty in accessing liquidity at the price that he is obligated to provide. This is particularly true in the case of manually-executed orders, given the associated time latency and the frequency with which quotes in other markets are changing.

Many CHX specialists, thus, believe that 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. Indeed, they believe that in today's trading environment, the limit order execution guarantee exposes them to unwarranted liability, which they often have limited ability to mitigate.⁶

In short, the CHX believes that the environment has changed significantly since it voluntarily enacted its rule-based execution guarantees, warranting the amendments proposed by the CHX. The CHX believes that the guarantees no longer foster significant competition between markets. Absent this benefit to investors, the Exchange believes that there is no legal basis for continuing to mandate such guarantees, which, as discussed above, are not required under the Act or other requirements promulgated by Congress or the Commission. Accordingly, the Exchange believes that it is appropriate to render such guarantees voluntary, on the terms outlined below.

Proposed Rule Change

Under the proposed revision to CHX Article XX, Rule 37(a)(3), the mandate that CHX specialists guarantee execution of resting limit orders for listed issues, based on triggering activity in other markets, would be deleted. Instead, the amended rule would permit CHX specialists to continue to provide such guarantees solely on an issue-by-issue basis, on non-discriminatory terms approved by the Exchange. The Exchange's existing functionality providing for automated execution of resting limit orders would remain available for CHX specialists who elect to continue to guarantee limit order protection.⁷

⁶ In fact, the exposure of a CHX specialist exceeds that of a specialist on the primary market, whose best execution obligation effectively requires only that he guarantee a limit order execution, if another market executes an order at a price *better* than the limit price. Under the current CHX rule, the CHX specialist is required to execute a limit order, if the primary market executes an order *at* the limit price.

⁷ The Exchange anticipates that for the foreseeable future, CHX specialists would continue to provide limit order protection voluntarily, using the criteria for voluntary limit order protection currently set forth in CHX Article XX, Rule 37(a)(3).

Significantly, deletion of the rule-based mandate regarding limit order protection would not remove a CHX specialist's obligation to provide a timely best execution for each order, nor would it modify any other specialist obligations set forth in CHX Article XXX of the CHX Rules. The CHX Department of Market Regulation would continue its surveillance of order executions to ensure that CHX specialists meet all of their obligations to each order. Accordingly, many CHX specialists would continue to execute resting limit orders for listed issues voluntarily, when quotes or executions at the limit price occur in other markets, as a means of satisfying their best execution obligations and maintaining superior execution quality statistics.

2. Statutory Basis

The Exchange believes that the proposal, as amended, 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.⁸ Specifically, the CHX believes that the proposal, as amended, is consistent with Section 6(b)(5) of the Act,⁹ in that 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.

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

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

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

To the extent that the Exchange approved some variation in the limit order protection criteria, the Exchange would notify all CHX participants of this change.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

(ii) as to which the self-regulatory organization 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. Please include File Number SR-CHX-2004-17 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 No. SR-CHX-2004-17. 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 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-2004-17 and should be submitted on or before August 4, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

J. Lynn Taylor,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52000; File No. SR-ISE-2005-21]

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendments No. 1 and 2 Thereto To Amend Its Summary Fine Schedule for Position Limit Violations

July 8, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 15, 2005, the International Securities Exchange, Inc. ("Exchange" or "ISE") 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 ISE. On June 23, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.³ On July 7, 2005, the Exchange filed Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice and order to solicit comments on the proposed rule change, as amended, from interested persons and to approve the proposal on an accelerated basis.

¹⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange amended the proposed rule change such that under proposed ISE Rule 1614(d)(1)(B): (1) fines for member accounts would be based on the number of violations in any 12-month rolling period and not within one calendar year; and (2) the \$5,000 fine proposed by the Exchange would be for the fourth and each subsequent offense and not just for the fourth offense.

⁴ In Amendment No. 2, the Exchange added a footnote to ISE Rules 1614(d)(1)(A) and (B) providing that (i) a one-trade date overage, (ii) a consecutive string of trade date overage violations where the position does not change or where a steady reduction in the overage occurs, or (iii) a consecutive string of trade violations resulting from other mitigating circumstances, may be deemed to constitute one offense, provided that the violations are inadvertent.