

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49721; File No. SR-CHX-2004-10)

May 18, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Inc. Relating to Co-Specialist Assignments and Evaluations

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, 2004 the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by CHX. On May 12, 2004, the Commission received Amendment No. 1 to the proposed rule change.<sup>3</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 the Substance of the Proposed Rule Change

CHX proposes to amend Interpretations .01 and .02 to Article XXX, Rule 1 of the CHX Rules and to add a new Interpretation .04. These new and revised provisions would govern the assignment of securities to co-specialists and the evaluation of co-specialist trading activity. The text of the proposed rule change is set forth below. New text is italicized. Deletions are in brackets. In addition, the Exchange proposes changes to its floor member questionnaire. A copy

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

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

<sup>3</sup> See letter from Ellen J. Neely, Senior Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated May 11, 2004 (“Amendment No. 1”). Amendment No. 1 superseded and replaced the original rule filing in its entirety.

of the proposed new questionnaire is available from the Office of the Secretary of the Commission or the CHX.

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Chicago Stock Exchange Rules

ARTICLE XXX

Specialists

RULE 1. No change to text.

· · · Interpretations and Policies

.01 [Committee on Specialist Assignment & Evaluation]

COMMITTEE ON SPECIALIST ASSIGNMENT AND EVALUATION

ASSIGNMENT FUNCTION

I. EVENTS LEADING TO ASSIGNMENT PROCEEDINGS

1-6. No change to text.

7. Unsatisfactory Performance Action.

(a) The Committee shall periodically evaluate the performance of co-specialists as described in Interpretation and Policy .04. As part of that process, the Committee may, from time to time, take steps to encourage a unit to reallocate books in the case of unsatisfactory performance by a co-specialist.

For example, based on the informal hearing with a co-specialist described in Article XVII, Rule 2, the Committee may believe that the co-specialist cannot bring his performance up to the required level within a reasonable period of time. The Committee may then encourage the specialist to reassign the issues to a stronger co-specialist. Because the Committee does not want any disincentive for the specialist unit to assign issues to the strongest

possible co-specialist, it will permit reallocation without posting in such circumstances prior to a final determination by the Committee to reassign an issue. Any such intrafirm transfer should be to an obviously stronger co-specialist.

(b[a]) When a co-specialist or specialist has [low evaluation ratings] unsatisfactory performance, the Committee may also proceed according to Article XVII[, of Rule 2] of the Rules of the Exchange to re-assign one or more issues traded by that co-specialist by suspending his registration in the securities or by terminating his registration in the securities. The Committee may also require a specialist to reassign the issue to a satisfactory performer.

A co-specialist's or specialist's registration, in one or more of the securities in which he or it is registered, may be suspended or terminated by the Committee on Specialist Assignment and Evaluation upon a determination that the co-specialist has not satisfactorily performed his responsibilities as co-specialist. A determination by the Committee on Specialist Assignment and Evaluation to suspend or terminate a co-specialist's or specialist's registration may be based on (a) any statistical data on the co-specialist's activities or performance as co-specialist, including data identifying a co-specialist's violations of Federal law and/or Exchange rules and policies and data that reveals the quality of the co-specialist's order executions; and (b) any action previously taken against the co-specialist for unsatisfactory performance and shall be made in accordance with rules of the Exchange establishing fair procedures, such as those set out in Article XVII of the Exchange's Rules. Once the Committee has made a formal determination that the performance of a co-specialist is unsatisfactory and that the books should be reassigned, the books will be posted without an opportunity for an intra-unit transfer.[Only co-specialists will be periodically evaluated since only co-specialists actually trade the book. Relief specialists only trade the book in the absence or inability of the co-specialists to do so. Specialists have the

financial responsibility for the book and for any actions, errors or omissions of the co-specialists, or relief specialists for the particular book.]

[(b) From time to time, the Committee may take steps to encourage a unit to reallocate books in the case of unsatisfactory performance by a co-specialist.]

[(i) For example, based on an informal hearing with a co-specialist, the Committee may believe that the co-specialist can bring his performance up to the required level within a reasonable period of time. The Committee may then encourage the specialist to reassign the issues to a stronger co-specialist. Because the Committee does not want any disincentive for the specialist unit to assign issues to the strongest possible co-specialist, it will permit reallocation without posting in such circumstances prior to a final determination by the Committee to reassign an issue. Any such intrafirm transfer should be to an obviously stronger co-specialist.]

[(ii) In the case of continued unsatisfactory performance by a co-specialist, the Committee may require the specialist to reassign the issue to a satisfactory performer.]

[(iii) Once the Committee has made a formal determination that the performance of a co-specialist is unsatisfactory and that the books should be reassigned, the books will be posted without an opportunity for an intra-unit transfer.]

8. No change to text.

## II. ASSIGNMENT PROCEDURES

2. Decision Making. The Committee will hold assignment meetings as appropriate, consistent with the schedules of the Committee members. In advance of each meeting, members of the Committee will be provided by the Exchange with data on the securities to be assigned, copies of the applications, and the most recent performance evaluation ratings and other data on

the applicants and the relevant co-specialist. Applicants will receive, a reasonable time prior to the meeting, copies of the data relating to their own performance that is shared with the Committee and may make personal appearances at the assignment meetings in support of their applications. These appearances will begin at 3:30, if the applicants request this meeting time to accommodate floor members' schedules. Before all personal appearances, a closed meeting of the Committee will be held to review all data provided to the Committee by the Exchange.

In the absence of applications which the Committee considers acceptable, the Committee may assign a new security to any unit which it believes to be qualified. If there are no acceptable applications for a security that is up for reassignment, the Committee may leave the stock with the incumbent specialist unit or reassign it to a new unit which it believes to be qualified.

3. - 5. No change to text.

### III. GUIDELINES FOR ASSIGNMENT OF ISSUES TO CO-SPECIALISTS

1. Basic Standard. In reviewing an application to act as the specialist in a security, the Committee will, in addition to evaluating the qualifications of the specialist unit, consider the designated co-specialist's demonstrated ability, experience and financial responsibility in accordance with Article XXX, Rule 1 of the Rules.

The Committee will determine the respective weights to be given to each of these three factors in arriving at a decision as to whether to approve or disapprove any particular application. In deciding among applicants who have designated co-specialists with approximately comparable demonstrated ability and experience, the Committee may consider additional factors, including the number and type of stocks in which each designated co-specialist is already registered as co-specialist, recent registration decisions and the overall best interest of the Exchange.

(a) Demonstrated ability. In evaluating demonstrated ability, the Committee will rely primarily on:

1. the results of the co-specialist evaluation questionnaire, including individual comments from responding floor brokers;

2. other statistical data on the designated individual's activities or performance as a co-specialist, including [surveillance] data identifying a co-specialist's violations of Federal law and/or Exchange rules and policies and data that reveals the quality of the co-specialist's order executions;

3. any action previously taken against the designated individual for unsatisfactory performance of his obligations as a co-specialist; and

4. any other information submitted to the Committee, by the applicant or by any other person or entity, which bears on the designated individual's ability to carry out the responsibilities of a co-specialist.

Of these sources of information, the Committee will give substantial weight to the data that reveals the quality of the co-specialist's order executions [co-specialist evaluation questionnaire and may give varying weights to individual questions in the questionnaire]. All information will be evaluated in terms of the standards in the co-specialist job description and the Code of Acceptable Business Practices for co-specialists, with particular emphasis on (i) the co-specialist's demonstrated ability to make continuous two-sided markets in depth, and (ii) the co-specialist's demonstrated ability to trade in such a manner as to increase the order flow to the Exchange and, hence, the competitiveness of its market with markets elsewhere.

(b) No change to text.

(c) No change to text.

.02 CO-SPECIALIST JOB DESCRIPTION

I. GENERAL

[I. General]

An Exchange member who is registered as a co-specialist is accountable to the Exchange and the investing public for the quality of the Exchange markets in the securities in which he is registered and is responsible for fostering and acting to maintain liquid and continuous two-sided auction markets on the Exchange Floor in those securities. This is accomplished by his acting as agent and principal in such securities, in accordance with the provisions of Federal law and Exchange rules and policies, to help insure that such markets are fair, orderly and operationally efficient in the public interest, and competitive with non-Exchange markets in those securities. A “fair” market is one which is free from manipulative and deceptive practices and which affords no undue advantage to any of the participants therein. An “orderly” market is one with regularity and reliability of operation manifested by the presence of price continuity and depth exhibited by the avoidance of large and unreasonable price variations between consecutive sales on the consolidated tape for Dual Trading System issues, on the Exchange tape for exchange issues and on the NASDAQ System for Nasdaq/NM Securities and the avoidance of overall price movements, without appropriate accompanying volume.

[A co-specialist’s continuing registration in the securities in which he is registered is dependent upon his satisfactory performance of his responsibilities as a co-specialist as defined in Federal and Exchange rules, interpretations, releases and notices, this job description, the Code of Acceptable Business Practices for co-specialists and the rules and practices for trading on the Exchange. A co-specialist’s registration, in one or more of the securities in which he is registered, may be suspended or terminated by the Committee on Specialist Assignment and Evaluation upon a determination that he has not satisfactorily performed his responsibilities as

co-specialist. A determination by the Committee on Specialist Assignment and Evaluation to suspend or terminate a co-specialist's registration may be based on answers by floor members to questionnaires sent out by the Committee and shall be made in accordance with rules of the Exchange establishing fair procedures.]

## II. PRINCIPAL DUTIES

[II. Principal Duties]

## III. ELIGIBILITY REQUIREMENTS

[III. Eligibility Requirements]

### .03 CODE OF ACCEPTABLE BUSINESS PRACTICES FOR CO-SPECIALISTS

No change to text.

### .04 CO-SPECIALIST PERFORMANCE EVALUATION

A co-specialist's continuing registration in the securities in which he is registered is dependent upon his satisfactory performance of his responsibilities as a co-specialist as defined in Federal and Exchange rules, interpretations, releases and notices, the Co-Specialist Job Description, the Code of Acceptable Business Practices for co-specialists and the rules and practices for trading on the Exchange.

The Committee on Specialist Assignment and Evaluation shall periodically evaluate the performance of co-specialists. The Committee may choose, in its discretion, to evaluate the performance of relief or temporary specialists.

## I. PERFORMANCE LEADING TO AUTOMATIC MEETING WITH COMMITTEE

The Committee shall review data, compiled on an issue-by-issue basis, which identifies the co-specialists who have had low order execution quality scores in two consecutive evaluation periods when compared to other co-specialists. For purposes of this provision, an "evaluation

period” is a period of three months. The term “order execution quality score” means the cumulative score, in a particular issue, of two equally-weighted factors derived from data compiled pursuant to SEC Rule 11Ac1-5: (a) effective spread index, and (b) speed of execution. The term “bottom tier” shall mean the bottom 5% of all stocks traded by co-specialists, when ranked using the order execution quality score.

If a co-specialist’s order execution quality score for any security is in the bottom tier, for two consecutive periods, of the ranking reviewed by the Committee, the co-specialist shall be notified of that fact and shall be required to have an initial meeting with one or more members of the Committee, as described in Article XVII, Rule 2. These meetings shall take place as soon as reasonably possible after the end of each applicable evaluation period. Based on the results of that meeting, the Committee may take a variety of informal actions designed to provide encouragement and assistance to the co-specialist, including, but not limited to, encouraging the specialist firm to reallocate part of the co-specialist’s book. Nothing in this rule would permit the Committee, however, to suspend the co-specialist’s registration or reallocate a security in which the co-specialist is registered without the use of the procedures described in Article XVII.

## II. OTHER PERFORMANCE MEASURES LEADING TO POSSIBLE MEETING WITH COMMITTEE

The Committee shall have the ability to review any other data relevant to a co-specialist’s performance such as (a) any statistical data on the co-specialist’s activities or performance as co-specialist (including data identifying a co-specialist’s violations of Federal law and/or Exchange rules and policies and other data that reveals the quality of the co-specialist’s order executions); and (b) any action previously taken against the co-specialist for unsatisfactory performance. The Committee may determine, based on any or all of these performance measures, that a co-

specialist's performance warrants the initial meeting described in Article XVII, Rule 2 and may take, as a result of that meeting, any of the actions described above.

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

In its filing with the Commission, CHX included statements concerning the purpose of, and basis for, the proposed rule change, as amended, and discussed any comments it received on the proposal. The text of these statements may be examined at the places specified in Item IV below. 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 Change

1. Purpose

Under the Exchange's rules, the Committee on Specialist Assignment and Evaluation ("CSAE") is charged with the responsibility of assigning new securities to co-specialists and evaluating the work of those co-specialists after the securities are assigned. Article XXX, Rule 1, Interpretation .01 describes the assignment process followed by the CSAE and identifies the factors that the CSAE should consider in making its assignment decisions. This interpretation also describes the situations where the CSAE may re-assign a security due to the unsatisfactory performance of a co-specialist or specialist. Interpretation .02 to the same rule contains the co-specialist job description and a code of acceptable business practices for co-specialists. This submission seeks to make changes to both of those provisions and to add a new section, Interpretation .04, to set out a specific co-specialist performance evaluation process. In addition, the Exchange proposes to revise its floor member questionnaire.

Assignment decisions. When reviewing a member firm's application to act as the specialist in a security, the CSAE evaluates the qualifications of both the specialist unit as a whole and the individual co-specialist who is designated to trade the security. In reviewing a co-specialist's qualifications, existing CHX rules permit the CSAE to consider specific factors relating to the co-specialist's demonstrated ability, experience and financial responsibility.<sup>4</sup> The CHX rules also permit the CSAE to consider additional factors, such as the number and type of stocks in which the co-specialist is already registered and the overall best interest of the Exchange.

This submission seeks to clarify the factors used by the CSAE in determining a co-specialist's demonstrated ability. Specifically, under this proposal the Exchange would (1) specifically confirm that the CSAE will review execution quality data during the assignment process; and (2) require that the CSAE give substantial weight to this execution quality data (instead of the results of the co-specialist evaluation questionnaire) when making its assignment decisions. These changes are designed to recognize the Exchange's view that the quality of the order executions given by a co-specialist should be one of the primary factors used by the CSAE in determining whether an individual should be designated as a co-specialist in a new security.<sup>5</sup>

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<sup>4</sup> For example, when evaluating a co-specialist's demonstrated ability, the CHX rules require the CSAE to rely primarily on the results of the co-specialist evaluation questionnaire, other statistical data relating to the co-specialist's performance, any action previously taken against the co-specialist for unsatisfactory performance as a co-specialist, and any other information submitted by the applicant which bears on the person's ability to perform his co-specialist obligations. See CHX Article XXX, Rule 1, Interpretation and Policy .01 (III)(1)(a).

<sup>5</sup> Four minor changes to CHX Article XXX, Rule 1, Interpretation and Policy .01(II) and (III), are designed (1) to confirm that CSAE assignment meetings will take place after the close of trading only if requested by an applicant for a security; (2) to make clear that the CSAE will consider information submitted by any person, not just by the applicant, that bears on an individual's ability to carry out the responsibilities of a co-specialist; (3) to confirm that, prior to an assignment meeting, the Exchange will provide each co-

Co-specialist evaluations. In addition to the proposed changes to the CHX rules governing the CSAE’s assignment of securities, this submission seeks to set out a new co-specialist performance evaluation process and to change the CHX rules governing the CSAE’s decisions to remove a security from a particular co-specialist.

a. In proposed Interpretation .04 (“Co-Specialist Performance Evaluation”), the Exchange describes a new process through which the CSAE would evaluate co-specialist performance against objective performance measures that employ a system of relative rankings. Specifically, the proposal would require the CSAE, or a subgroup of the CSAE, to hold a special performance meeting with the co-specialists who, on an issue-by-issue basis, rank (for two consecutive evaluation periods) in the bottom 5% of a special order execution quality score. The order execution quality score would be composed of two equally-weighted factors derived from data reported under SEC Rule 11Ac1-5: (1) effective spread; and (2) speed of execution.<sup>6</sup>

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specialist with copies of data that is being shared with the CSAE about that co-specialist; and (4) to replace a somewhat ambiguous reference to “surveillance data” with text confirming that the CSAE is given data “identifying a co-specialist’s violations of Federal law and/or Exchange rules and policies.” This last change is not designed to change the information currently provided to the CSAE – the CSAE now receives data about rule violations that have resulted in fines under the Exchange’s Minor Rule Violation Plan or in sanctions issued as a result of formal disciplinary proceedings – but merely to more accurately describe the information that is provided.

<sup>6</sup> The calculated score includes factors that compare an Exchange specialist’s performance to the performance of the person or persons making markets in a designated market used as the competitive benchmark for the security. For example, in calculating the number of points for a co-specialist with respect to the effective spread in a particular stock, the Exchange would: (1) Calculate a share-weighted effective spread for the co-specialist, in each of the four Rule 11Ac1-5 order size levels, for both market and marketable limit orders, by multiplying the effective spread taken from each month’s Rule 11Ac1-5 data by the number of shares traded on the Exchange, accumulating three months of data (because the evaluation period is three months long) and then dividing the share-weighted shares by the total number of shares traded on the Exchange; (2) Calculate a share-weighted effective spread for the appropriate competitive benchmark, using the same

Although the CSAE intends to begin this new evaluation process by ranking co-specialists in all of the securities assigned for specialist trading, the CSAE may later choose to review co-specialist order execution quality scores as part of a ranking of the scores in smaller subgroups of securities traded by co-specialists.<sup>7</sup> Finally, this section of the proposal provides that the Committee may choose to use additional measures for evaluating specialist performance.<sup>8</sup>

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technique; (3) Determine the percentage difference between the CHX co-specialist and the competitive benchmark and convert the result into whole numbers; and (4) Add the points for each order size level to determine the overall point score for the effective spread in the security.

Similarly, in determining the points associated with speed of execution, the Exchange would (1) Calculate a share-weighted speed of execution for the CHX co-specialist in each of the Rule 11Ac1-5 order size levels, within each of the NBBO buckets (at the NBBO, inside the NBBO and outside the NBBO) by multiplying the number of executed shares in each bucket by the execution times set out in the Rule 11Ac1-5 data and then dividing that number by the total number of shares that were executed on the Exchange; (2) Calculate a share-weighted speed of execution for the competitive benchmark, using the same technique; (3) Determine the percentage difference between the CHX co-specialist and the competitive benchmark and convert the result into whole numbers; and (4) Add the points for each order size level to determine the overall point score for speed of execution in the security.

To determine an overall score for a co-specialist, the Exchange would then add together the total effective spread points and the total speed of execution points.

<sup>7</sup> If the Committee chooses to rank co-specialist order execution quality scores within a smaller subgroup of securities, the Exchange understands that it must identify that subgroup by filing a rule change proposal with the Commission. The Exchange intends to submit those filings as interpretations of existing Exchange rules under Section 19(b)(3)(A) of the Act and SEC Rule 19b-4(f)(1). Similarly, if the Exchange intends to use other order execution quality statistics in its performance review process, it will make additional submissions to the Commission to identify the data that it intends to use and the objective performance measures that relate to it.

<sup>8</sup> Importantly, the proposal is integrated with the procedures that already exist for handling unsatisfactory performance by co-specialists. Under Article XVII of the Exchange's Rules, the CSAE may remove a co-specialist's registration in a particular security after (a) holding an initial, informal meeting with the member; and, if performance does not improve, (b) convening a more formal hearing to determine whether it is appropriate to take one or more securities away. The new performance evaluation process causes the CSAE to hold the first of these meetings with co-specialists who rank in the bottom 5%

b. Under the Exchange's existing rules, the CSAE may suspend or terminate a co-specialist's registration in a security based on the answers given by floor members to the co-specialist evaluation questionnaire.<sup>9</sup> This proposal would modify those rules to explicitly state that the CSAE may suspend or terminate a co-specialist's registration in an issue using factors almost identical to those used in making the initial decision to assign the security to the co-specialist, but not on the responses to the floor broker questionnaire.<sup>10</sup> Specifically, this proposal would allow a CSAE removal or suspension decision to be based on statistical data (such as order execution quality information, including the special order execution quality score described above, and data regarding a co-specialist's disciplinary history) and on actions previously taken against the co-specialist for unsatisfactory performance.<sup>11</sup>

These changes are designed to recognize the Exchange's view that the results of the co-specialist questionnaire are not the most appropriate factor that the CSAE should consider in making any decision to remove a security from a co-specialist. Other factors, including the

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of the special order execution quality score for two consecutive evaluation periods. The Exchange will not use order execution quality statistics other than those described in this filing in its performance evaluation process without submitting the rule change proposal under Section 19(b) of the Act. Telephone conversation between Ellen J. Neely, Senior Vice President and General Counsel, CHX, and Leah Mesfin, Attorney, Division, Commission, on May 17, 2004.

<sup>9</sup> See CHX Article XXX, Rule 1, Interpretation and Policy .01(I)(7) and Interpretation and Policy .02(I).

<sup>10</sup> See proposed new text in CHX Article XXX, Rule 1, Interpretation and Policy .01(I)(7). In addition to this new language, the CHX has proposed moving some of the text from Interpretation and Policy .02(I) to this section to combine into one location the discussion of unsatisfactory performance actions.

<sup>11</sup> The only other assignment factor that is not contained in this proposed list is one that permits the CSAE to consider other information that bears on the co-specialist's ability to carry out his or her responsibilities.

individual's disciplinary history and the quality of the executions given to orders are, in many ways, better indicators of a co-specialist's performance.

The revised floor member questionnaire. Over the past several years, the Exchange has used a questionnaire that asks its floor members to rate the performance of CHX co-specialists in eight different categories.<sup>12</sup> A supplement to the survey required floor members to identify the number of interactions that they had with a particular co-specialist in an average trading month. Ratings were made on a scale of one to five, with five being the highest rating.<sup>13</sup> In recent evaluation periods, the vast majority of co-specialists received overall ratings (when the individual ratings are combined) that hovered around a score of three.

In recent months, the Exchange has worked to revise the questionnaire so that it is both more efficient for floor members to complete and more helpful to the CSAE. The revised questionnaire asks that a floor member give a single numerical rating (on a scale of one to three) to the overall performance of each individual co-specialist, evaluated against nine criteria.<sup>14</sup>

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<sup>12</sup> These categories seek ratings as to how well a co-specialist (1) displays bids and offers for actively traded issues; (2) accepts and fills orders in thinly traded issues; (3) executes public limit orders on a timely basis; (4) fills retail orders when the order is larger than the best bid or offer; (5) deals with professional orders; (6) deals with the block cross situation; (7) provides information to brokers; and (8) resolves and adjusts errors.

<sup>13</sup> Within each category, the form provided additional text that was presumably designed to guide the floor member in choosing the appropriate rating. For example, in the category relating to resolution and adjustment of errors, this text noted that a rating of one means that a co-specialist "refuses to take an error even if it is the specialist's fault;" that a rating of three means that a specialist "usually resolves and adjusts errors in a fair manner;" and that a rating of five means that a specialist "always resolves and adjusts errors in a fair manner."

<sup>14</sup> These new categories – which incorporate many of the same concepts embodied in the original criteria – require consideration of how well a co-specialist (1) displays public orders; (2) accepts and fills orders pursuant to minimum requirements; (3) executes public limit orders on a timely basis; (4) is generally helpful in providing depth and liquidity when necessary; (5) accepts and reflects bids and offers that better the existing market (i.e., professional orders); (6) does not inappropriately interfere with cross trades;

Floor members must also rate the performance of each specialist firm against the same nine criteria, providing one overall rating for each firm. The questionnaire requests that a floor member provide a written description of any reasons supporting a score of one, which would indicate performance that “does not meet” the criteria. By requiring the floor members to provide one overall score for each co-specialist or specialist firm – but while also receiving written explanations of the reasons for any scores of one – the CSAE believes that it will secure the basic information that it needs to conduct this facet of its evaluation of co-specialists and specialist firms. In addition, the shortened form, which replaces the current eight separate ratings in distinct categories with one overall rating that covers nine separate performance measures, would allow the Exchange’s floor members to provide important input on specialist performance while not being required to spend an excessive amount of time doing so.<sup>15</sup>

## 2. Statutory Basis

The proposed rule 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,

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(7) provides relevant information to floor brokers; (8) resolves and adjusts disputes in a timely and fair manner; and (9) adheres to all applicable rules of the Exchange. The last criterion – which seeks input on a co-specialist’s adherence to applicable Exchange rules – was added to questionnaire to provide floor members with an opportunity to rate a co-specialist’s compliance with rules other than those set out in criteria (1) through (8).

<sup>15</sup> The Exchange distributes these surveys twice each year, seeking floor member input on specialist performance. Representatives of floor broker firms participated in the re-design of the form, in large part because of their desire to ensure that the form does not impose unnecessary burdens on the people who are required to complete it, while still providing relevant performance information to the CSAE. The existing version of the form was viewed by these members as requiring too much time to complete, particularly when floor brokers have increased their use of automated means to send orders to specialists, thus decreasing the number of personal interactions between the two groups. The floor members who participated in the re-design of the form and the CSAE believe that the new form will provide an efficient tool for seeking floor member input, while not imposing unnecessary burdens.

with the requirements of Section 6(b).<sup>16</sup> In particular, the proposed rule is consistent with Section 6(b)(5) of the Act<sup>17</sup> 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 on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any inappropriate 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 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 self-regulatory organization 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 proposed rule change, as amended, including whether it is consistent with the Act.

Comments may be submitted by any of the following methods:

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<sup>16</sup> 15 U.S.C. 78f(b).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

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-2004-10 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 Number SR-CHX-2004-10. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of 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 Number SR-CHX-2004-10 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.<sup>18</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).