

The Chicago Stock Exchange

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U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.
20549-1001
DIVISION OF MARKET REGULATION

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Robert L. D. Colby
Deputy Director
Division of Market Regulation
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: Request for No-Action Relief Relating to Section 31 of the Exchange Act and Rule 31 thereunder

Dear Mr. Colby:

This letter respectfully requests that the staff of the Division of Market Regulation of the Securities and Exchange Commission (the "SEC" or the "Commission") advise the Chicago Stock Exchange, Incorporated (the "CHX") that it will not recommend any enforcement action to the Commission if the CHX makes certain adjustments to the covered sales data supplied by the National Securities Clearing Corporation ("NSCC") under new Rules 31 and 31T and includes this adjusted data in the Forms R31 submitted by the CHX to the Commission.

Background

Under Section 31(b) of the Exchange Act, each national securities exchange is required to pay the Commission a fee based on the aggregate dollar amount of covered sales of securities on that exchange (a "Section 31 fee").¹ In January 2004, the Commission proposed a uniform procedure for the calculation and collection of Section 31 fees, which was designed "to make the Section 31 calculation and collection process more transparent, accurate and reliable."² The new procedure proposed by the Commission, set out in new Rule 31, took effect in August 2004;

¹ See 15 U.S.C. 78ee(b). Certain securities – such as bonds, debentures, security futures products and options on certain securities indices – are not subject to Section 31 fees.

² See Release No. 34-49014 (January 20, 2004), 69 FR 4018 (January 27, 2004)(File No. S7-05-04).

temporary rule provisions (Rule 31T) confirm that the new procedure applies to the period beginning September 1, 2003.³

In general terms, under new Rule 31, the Section 31 fees due from national securities exchanges are based on transaction data provided by the exchanges to NSCC for clearing and settlement, as well as on other trade data that was not submitted to NSCC. Specifically, Rule 31 requires exchanges, each month, to complete a Form R31, providing the aggregate dollar amount of covered sales that occurred on that exchange during the month. Part I of Form R31 requires exchanges to report the aggregate dollar value of covered sales that occurred on the exchange and that the exchange reported to NSCC, as reflected in the data provided by NSCC. Parts II and III require exchanges to report the aggregate dollar value of covered sales that were not reported to NSCC by the exchange.

The data supplied by NSCC to the CHX for the periods from September 1, 2003 through August 2004, however, does not accurately reflect the aggregate dollar value of the covered sales that occurred on the CHX.⁴ Specifically, we believe that, while the NSCC-provided data includes all covered sales (except for the ex-clearing transactions separately reported by the CHX), the data also contains information about non-covered sales, including information about (a) reversals, (b) transactions that occurred on other markets through the Intermarket Trading System ("ITS"), (c) transactions that occurred in Nasdaq's SuperMontage trading system and (d) transactions involving a correspondent clearing flip. In an attempt to provide the Commission with an accurate view of the transactions that occurred on the CHX, the CHX made adjustments, in each of these categories of transactions, to the NSCC data in the Forms R31 that it filed for the months of September 2003 through August 2004.⁵ All of the adjustments to the NSCC data were necessary to ensure that the CHX reported the accurate dollar volume of covered sales of equity securities occurring on the CHX during the applicable reporting period.

Furthermore, the CHX believes that it will need to continue making these types of adjustments to the NSCC-supplied data until the NSCC has been able to implement changes to its systems to ensure that it is collecting (and providing to the CHX) accurate information about covered sales that occur on the CHX.⁶ Through this letter, the CHX asks that Staff confirm that

³ See Release No. 34-49928 (June 28, 2004), 69 FR 41060 (July 7, 2004)(Final Release).

⁴ The Exchange does not mean to suggest that the data issues described in this letter are the fault of NSCC. The retroactive application of Rule 31 necessarily requires NSCC to use data in the form supplied to it over the past year, when markets were not using that data to report covered sales under Section 31

⁵ The CHX provided detailed worksheets describing the process it used in making the adjustments and the dollar amounts involved in each change.

⁶ The CHX understands that NSCC is attempting to implement systems changes in early 2005 that should ensure the capture and sorting of the data needed to more accurately complete Form R31.

it would not take enforcement action against the CHX for making these types of adjustments on the Forms R31 that it submits to the Commission to accurately reflect the dollar value of covered sales on the CHX.⁷

Discussion

In the Final Release relating to Rule 31, the Commission recognized that, in certain ways, the NSCC data – particularly for the retroactive period from September 2003 through July 2004 – would not accurately identify the transactions that had occurred on each exchange. Indeed, the Commission noted:

With the equities exchanges, . . . the Commission understands that trade data going back to September 1, 2003, may not have been reported to NSCC in a form that can immediately be tabulated under the procedure created by new Rule 31. Nevertheless, the Commission believes that NSCC, with the assistance of the exchanges, can sift the data to produce an accurate record of each exchange's covered sales in equities since September 1, 2003.

Final Release, p. 48. In the Final Release, the Commission expressly identified certain areas in which the exchanges should work with NSCC to confirm the accuracy of the data, including transactions in debt securities; reversals; creations and redemptions of ETFs; trades cleared through, but not executed on, a covered SRO; cash, next-day and seller's options trades; and step-outs, universal flips and correspondent clearing transactions.⁸ After the Final Release was published, additional limitations of the NSCC data surfaced, and were discussed with the Staff, including, but not limited to, a better understanding of the limited utility of the ITS data that NSCC could provide.

Although NSCC is working to address the issues associated with its data, it has not yet been able to do so. At this point, then, the CHX cannot report accurate information on Form R31 unless it makes adjustments to the NSCC data that are based on data other than that provided by NSCC. We believe that, in making these adjustments, the Exchange is acting in a manner consistent with the spirit of the Commission's comments in the Final Release. We also believe that it can reasonably be inferred from the Commission's statements in the Final Release that, due to the fact that NSCC's historical data was not compiled in a manner that could readily yield

⁷ The Exchange understands that Staff cannot specifically confirm that the CHX's calculations with respect to each adjustment are accurate. The Exchange asks, however, that Staff confirm that it is appropriate, in principle, for the Exchange to reduce the NSCC-provided aggregate dollar amount of covered sales by the amounts associated with these types of transactions.

⁸ Id. at 48-51.

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an accurate measure of covered sales, other adjustments – besides those specifically discussed in the Final Release – might be necessary. Through this letter, we respectfully ask that the Staff confirm that it will not recommend to the Commission that enforcement action be taken against the Exchange respecting compliance with Section 31, Rule 31, Rule 31T and Form R31 to the extent that the CHX makes adjustments to the data provided by the NSCC to ensure that the data provided by the CHX in its Forms R31 accurately reflects the aggregate dollar amount of covered sales occurring on the CHX. The CHX requests that this no-action relief apply with respect to the data reported on Forms R31 submitted for the period September 1, 2003 and continuing until the NSCC's implementation of systems changes that allow the NSCC data to be an accurate record of each exchange's covered sales.

If you have any questions about this request, please do not hesitate to call me at 312/663-2496.

Sincerely,



Ellen J. Neely