

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65035; File No. SR-CHX-2011-20)

August 4, 2011

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change to Impose Certain Requirements on Exchange-Registered Institutional Broker Firms That Operate a Separate Non-Institutional Broker Unit Within the Firm

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 26, 2011, Chicago Stock Exchange, Inc. (“Exchange” or “CHX”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to add a rule to impose certain requirements on Exchange-registered Institutional Broker firms which operate a separate, non-Institutional Broker unit within the firm. The text of this proposed rule change is available on the Exchange’s website at ([www.chx.com](http://www.chx.com)), at the Exchange’s Office of the Secretary and in 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

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

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

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 Change

1. Purpose

The Exchange is proposing to add Rule 5 to Article 17 to permit Exchange-registered Institutional Broker (“Institutional Broker”) firms to establish and operate a separate, non-Institutional Broker unit within the firm. The Exchange proposes to add information barrier requirements for Institutional Brokers that wish to operate a separate unit within the larger firm to conduct business otherwise than as an Institutional Broker. By this proposal, the Exchange believes that it will enable existing and new Institutional Broker firms to engage in trading activities through the non-Institutional Broker unit in a manner which better delineates the activity occurring on and off the Exchange.

CHX-registered Institutional Brokers are an elective sub-category of Exchange Participants requiring registration with the Exchange and are subject to the obligations of Article 17 of the CHX rules, in addition to the other provisions of Exchange rules. Institutional Broker firms typically provide order handling and execution services for other broker-dealers or institutional clients, and are the successors to the floor brokers under the Exchange’s previous floor-based, auction trading model.<sup>3</sup> The Commission’s order approving the Exchange’s New Trading Model noted, “Institutional brokers would be deemed to be participants operating on the Exchange, although they would not effect transactions from a physical trading floor (since the Exchange will no longer have a physical trading floor) and could trade from any location. A customer order

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<sup>3</sup> The Exchange replaced its traditional auction marketplace with its New Trading Model beginning in 2006. See Securities Exchange Act Rel. No. 34-54550 (Sept. 29, 2006), 71 FR 59563 (Oct. 10, 2006) (SR-CHX-2006-05).

would be deemed to be on the Exchange when received by an institutional broker, but would not have priority in the Matching System until it is entered into the system.”<sup>4</sup> Although an Institutional Broker is deemed to be operating on the Exchange, the CHX is proposing to allow a separate unit within the larger Institutional Broker firm to execute orders otherwise than on the Exchange.<sup>5</sup>

New Rule 5 proposes to establish new conditions for an Institutional Broker firm that wishes to include another unit of the firm (the “non-Institutional Broker unit”) to conduct business otherwise than as an Institutional Broker, including the handling and execution of orders on the CHX, in other trading centers or in the over-the-counter (“OTC”) marketplace. The non-Institutional Broker unit would not be considered as part of the facilities of the Exchange and its trading activity would be treated the same as any other order sending Participant which is not registered as an Institutional Broker. Since the non-Institutional Broker unit will be acting as an order entry unit of the firm, it will be generally subject to the strictures of the Exchange’s rules, except as to Articles 16 and 17 which pertain to Market Makers and Institutional Brokers, respectively, on an exclusive basis. For purposes of applying the Exchange’s Schedule of Fees and Assessments, the activity of a non-Institutional Broker unit would not be considered as Institutional Broker activity. A multi-unit Institutional Broker firm would be required to establish and maintain information barriers between the Institutional Broker unit and non-Institutional Broker unit. Such information barriers will be required to be reasonably designed to prevent the Institutional Broker unit from having knowledge of unexecuted customer orders in possession of the non-Institutional Broker unit and likewise prevent the non-Institutional Broker unit from having knowledge of unexecuted customer orders in the possession of the Institutional Broker unit. The Institutional

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<sup>4</sup> Id., Section II.C. Institutional Brokers.

<sup>5</sup> See email from James Ongena, Vice President, Associate General Counsel, CHX, to Christopher Chow, Special Counsel, Commission, dated August 3, 2011.

Broker unit may, however, transmit an order to the non-Institutional Broker unit of the firm for purposes of handling and executing the order, and the non-Institutional Broker unit may likewise transmit an order to the Institutional Broker unit.

Through this filing, the Exchange proposes that Institutional Broker firms which wish to operate a non-Institutional Broker unit would be required to create and maintain adequate information barrier procedures. At the time an Institutional Broker firm wished to set up a non-Institutional Broker unit within the firm, it would be required to submit to the Exchange its Written Supervisory Procedures (“WSPs”) as they pertain to these information barrier procedures. At minimum, the WSPs will have to satisfactorily address (1) the manner in which the firm will satisfy the requirements of this rule (including the compliance and audit procedures it proposes to implement to ensure that the information barrier is maintained); (2) identify the names and titles of the person or persons responsible for maintenance, supervision and surveillance of the procedures; (3) make a commitment to provide the Exchange with such information and reports relating to its transactions as the Exchange may request; and (4) make a commitment to take appropriate remedial action against any person violating this rule or the Institutional Broker firm's internal compliance and audit procedures, as well as confirming that the firm recognizes that the Exchange may take appropriate remedial action for any such violation.

In addition, the proposed rule provides that the firm’s WSPs must describe the internal controls that the Institutional Broker firm will implement to satisfy each of the conditions stated in the rule, and the compliance and audit procedures proposed to implement and ensure that the controls are maintained. If the Exchange determined that the organizational structure and the compliance and audit procedures proposed by the Institutional Broker firm are acceptable, the Exchange would so inform the Institutional Broker firm, in writing. Unless the Exchange found

that an Institutional Broker firm's information barrier procedures were acceptable, an Institutional Broker firm may not conduct business other than on the Exchange.

The Exchange believes that the provisions regarding the information barrier procedures of new Rule 5 are sufficient to address the issues presented by the operation of a non-Institutional Broker unit within a firm which is an Exchange-registered Institutional Broker. The CHX understands that the non-Institutional Broker unit of such firms will largely function in a similar manner to other order sending firms which are not registered with the Exchange as an Institutional Broker or Market Maker pursuant to our rules. To the extent that the non-Institutional Broker wished to act as a Market Maker on the Exchange, it would have to comply with the more stringent information barrier procedures under Article 16, Rule 9 (Limitation on Dealings).<sup>6</sup> The Exchange believes that the information barrier procedures of proposed Rule 5 are adequate to provide a

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<sup>6</sup> Because market makers normally trade as principal, either against other customer orders of the firm or other, unaffiliated market participants, the heightened potential for conflicts of interest in their transactions requires a stricter separation between the market making and non-market making units of a single firm. For example, under Article 16, Rule 9, the information barrier procedures of market making unit must address the potential use or misuse of post-trade clearing information to compromise the information barrier. While Institutional Broker firms do trade from time-to-time as principal, they normally handle orders as agent for their customers. To the extent that a particular Institutional Broker firm conducts a significant amount of its business as principal, the Exchange will require that its information barrier procedures specifically address that activity in a manner which is reasonably designed to address any conflicts of interest. The Exchange currently conducts surveillance of the principal trading activity of Institutional Broker firms for compliance with our rules, such as the prohibition on trading ahead contained in Article 9, Rule 17. Since the principal purpose of creating a non-Institutional Broker unit is to have it considered to be not “on the Exchange,” the Exchange believes that proposed standards for information barrier procedures as set forth in new Rule 5 are adequate to address those concerns.

meaningful separation of the Institutional Broker and non-Institutional Broker units in order to ensure that the latter can fairly be treated as not being part of the Exchange's trading facilities.<sup>7</sup>

Finally, the Exchange is proposing an Interpretation and Policy to define the elements of an adequate information barrier procedure for purposes of new Rule 5. Proposed Interpretation and Policy .01 defines an "information barrier" is an organizational structure in which the Institutional Broker functions are conducted in a physical location separate from the locations in which the non-Institutional Broker activities are conducted. The Institutional Broker and non-Institutional Broker units should not use trading or order management systems which permit them to share information about orders or transactions being handled by each respective unit. However, upon request and not on his or her own initiative, an Institutional Broker Representative may furnish to persons at the same firm or an affiliated firm ("affiliated persons"), the same sort of market information that the Institutional Broker would make available in the normal course of its Institutional Broker activity to any other person. The Institutional Broker Representative must provide such information to affiliated persons in the same manner that he or she would make such information available to a non-affiliated person. An individual person may not simultaneously act as an Institutional Broker Representative and as a representative of the non-Institutional Broker unit. The Exchange believes that the information barrier requirements as set forth in the proposed Interpretation and Policy are reasonable and appropriate given the nature of the relationship between the Institutional Broker and non-Institutional Broker units. The CHX further believes that the articulation of these standards in the proposed Interpretation and Policy will provide clarity and direction to interested Institutional Brokers in creating their information barrier procedures.

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<sup>7</sup> The Exchange represents that it will implement as of the time this proposal is approved adequate oversight processes which are reasonably designed to ensure compliance by our Participants with the requirements of the provisions of this proposal.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general,<sup>8</sup> and furthers the objectives of Section 6(b)(5) in particular,<sup>9</sup> in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transaction in securities, to remove impediments and perfect the mechanisms of a free and open market, and, in general, to protect investors and the public interest by setting forth the rules and principles governing the trading activity of Institutional Brokers. By permitting an Institutional Broker firm to operate a separate non-Institutional Broker unit within the larger firm subject to the new information barrier requirements, the proposed new Rule 5 would provide protection to the customers of such firms. Rather than routing orders which were directed to the OTC marketplace to a third-party broker-dealer for execution, the proposed non-Institutional Broker unit of the firm could handle and execute such orders. The Exchange believes that this handling could reduce the possibility for errors in transmission from one firm to another, as well as eliminate potential costs imposed by the third-party broker-dealer which might have to be borne by the order sender or the Institutional Broker firm. The creation and maintenance of adequate information barrier procedures, which are subject to the review, approval and inspection of the Exchange, should help ensure that the Institutional Broker and non-Institutional Broker units are in fact being operated separately, and that treatment of the non-Institutional Broker unit as not being part of the facilities of the Exchange is appropriate.

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<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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 45 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 or disapprove 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 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](mailto:rule-comments@sec.gov). Please include File No. SR-CHX-2011-20 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CHX-2011-20. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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-2011-20 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

Elizabeth M. Murphy  
Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).