

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64686; File No. SR-CHX-2011-07)

June 16, 2011

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Approving a Proposed Rule Change to Amend Minor Rule Plan

I. Introduction

On April 20, 2011, the Chicago Stock Exchange, Inc. (“CHX” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change amending CHX Article 12, Rule 8 (Minor Rule Plan) (“MRP”) to incorporate additional violations into the MRP, increase the sanctions for certain violations, add censure authority to the MRP, eliminate the Minor Rule Violation Panel, clarify pleading requirements of a Respondent seeking to challenge a sanction by instituting a formal disciplinary proceeding, and make other minor changes. The proposed rule change was published for comment in the Federal Register on May 5, 2011.³ The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description

The Exchange proposed to make additional rules subject to punishment under its MRP. These rules relate to: (1) failure to notify the Exchange of a request to withdraw capital contribution (Article 3, Rule 6(b)); (2) failure to request Exchange approval of the transfer of equity securities of a participant firm (Article 3, Rule 11); (3) reporting of loans (Article 3, Rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 64370 (April 29, 2011); 76 FR 25727 (“Notice”).

12); (4) failure to provide the Exchange with information (Article 6, Rule 7); (5) impeding or delaying an Exchange examination, inquiry, or investigation (Article 6, Rule 9); (6) designation of e-mail addresses (Article 3, Rule 13); (7) registration and approval of personnel (Article 6, Rule 2(a)); (8) written supervisory procedures (Article 6, Rule 5(b)); (9) failure to report short positions (Article 7, Rule 9); (10) furnishing of records (Article 11, Rule 1); (11) maintenance of books and records (Article 11, Rule 2); (12) participant communications (Article 11, Rule 4); (13) market maker registration and appointment (Article 16, Rule 1); (14) market maker reporting of position information (Article 16, Rule 10); (15) institutional broker registration and appointment (Article 17, Rule 1); (16) reporting of transactions (Article 9, Rule 13); (17) institutional broker obligations for entry of orders into an automated system (Article 17, Rule 3(a)); and (18) institutional broker responsibilities for handling orders within an integrated system (Article 17, Rule 3(b)). The Exchange believes that it will be able to carry out its regulatory responsibility more quickly and efficiently by incorporating these violations into its MRP.

The Exchange also proposed to increase the fine levels for certain violations. The Exchange proposed to increase the maximum fine pursuant to the MRP from \$2,500 to \$5,000 and to increase the fines in the Fine Schedule in order to better deter violative activity and more closely adhere to the fine schedules of other self-regulatory organizations. For most reporting and recordkeeping rule violations and certain trading rule violations, the recommended fines were increased from \$100/\$500/\$1000 for first, second, and third tier fines, respectively, to \$250/\$750/\$1500. The Exchange also proposed recommended fines of \$500/\$1000/\$2500 for other, more serious trading rule violations (i.e., ones which involve the potential for customer harm), as well as violations of the obligation to establish, maintain, and enforce written

supervisory procedures, and to provide information to the Exchange in connection with regulatory inquiries or other matters. The Exchange recommended fines of \$1000/\$2500/\$5000 for the most serious violations contained within the Plan (Trading Ahead). Finally, the Exchange proposed to expand the rolling time period in which violations would result in escalation to the next highest tier from 12 to 24 months, which is consistent with the minor rule plans of other exchanges.

In conjunction with altering the fine levels, the Exchange proposed to add a censure authority to the MRP to provide additional flexibility in imposing sanctions in particular cases. A censure could be used in the initial findings of a violation where the Exchange wants to put the Respondent on notice that certain conduct violates CHX rules or in other circumstances in which a monetary fine is not appropriate or necessary.

The Exchange proposed to eliminate the role of the Minor Rule Violation Panel in issuing sanctions pursuant to the MRP, and to authorize certain members of the Exchange's Market Regulation staff to issue MRP sanctions. Specifically, MRP sanctions would be imposed either by the Exchange's Chief Enforcement Counsel or Chief Regulatory Officer. The Exchange noted that allowing members of its staff to issue MRP fines was consistent with the practice at other exchanges regarding MRPs and was also similar to the method by which formal disciplinary actions are instituted by the CHX under Article 12, Rule 1.⁴ The Exchange stated that the proposed change would help to expedite the process of issuing MRP sanctions and

⁴ See, e.g., Chicago Board Options Exchange ("CBOE") Rule 17.50(a), Imposition of Fines for Minor Rule Violations (provides for fines to be issued by "the Exchange"); BATS Exchange Rule 8.15(a), Imposition of Fines for Minor Violation(s) of Rules, (provides for fines to be issued by "the Exchange"); International Stock Exchange Rule 1614(a), Imposition of Fines for Minor Rule Violations (provides for fines to be issued by "the Exchange"). Formal disciplinary actions under CHX Article 12, Rule 1 are authorized by the Exchange's Chief Regulatory Officer.

would eliminate an inherent source of potential conflicts (or appearance thereof) whenever Participants determine disciplinary sanctions.

The Exchange also proposed to clarify the pleading requirements of a Respondent who seeks to challenge a sanction by instituting a formal disciplinary proceeding. The proposed changes would require a Respondent challenging an MRP sanction to file an answer that meets the standards for an answer under Article 12, Rule 5(b). The proposal would authorize the Secretary of the Exchange (the person to whom such responses are directed) to deny the answer for a failure to meet these standards. Under the proposal, the denial of the answer by the Secretary without leave to amend and refile would be considered the final action of the Exchange, and the MRP fine would become due and payable and/or a censure would be imposed. The Exchange also added language incorporating the requirement of Exchange Act Rule 19d-1 relating to the reporting of Exchange disciplinary actions to the Commission.⁵

Finally, the Exchange proposed to make certain non-substantive, clarifying changes to some of the current rules referenced in the MRP. For example, the filing proposed to clarify that the short sale rule (Article 9, Rule 23) applied to all sell orders and not just those of a proprietary nature.⁶ In addition, the filing proposed to make changes to address proper rule cites and/or description of rules. For example, the filing proposed to clarify that an institutional broker's best execution obligations under Article 17, Rule 3 specifically fall under paragraph (d) of such rule. In addition, rather than describing the rule as "Failure to meet best execution obligations", the rule will be titled "Institutional Broker obligations in handling orders (best execution)."

⁵ The Exchange's proposed language is based upon language in the Minor Rule Violation Plan of the CBOE. See CBOE Rule 17.50(a).

⁶ Currently, the Plan only addresses a Participant's duty to comply with the short sale rule when selling short for its own account (e.g., proprietarily). See Article 12, Rule 8(h)(ii)(5).

III. Discussion and Commission's Findings

The Commission finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁷ In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,⁸ which requires that the rules of an exchange be designed to, among other things, protect investors and the public interest. The Commission also believes that the proposal is consistent with Sections 6(b)(1) and 6(b)(6) of the Act,⁹ which require that the rules of an exchange enforce compliance with, and provide appropriate discipline for, violations of Commission and Exchange rules. The Commission notes that because CHX Article 12 provides procedural rights to a person fined under the MRP to contest the fine and permits a hearing on the matter, the Commission believes that the MRP provides a fair procedure for the disciplining of members and persons associated with members, consistent with Sections 6(b)(7) and 6(d)(1) of the Act.¹⁰ Furthermore, the Commission believes that the proposed changes to the MRP should strengthen the Exchange's ability to carry out its oversight and enforcement responsibilities as a self-regulatory organization in cases where full disciplinary proceedings are unsuitable in view of the minor nature of the particular violation. Therefore, the Commission finds that the proposal is consistent with the public interest, the protection of investors, or otherwise in furtherance of the

⁷ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f(b)(5).

⁹ 15 U.S.C. 78f(b)(1) and 78f(b)(6).

¹⁰ 15 U.S.C. 78f(b)(7) and 78f(d)(1).

purposes of the Act, as required by Rule 19d-1(c)(2) under the Act,¹¹ which governs minor rule violation plans.

In approving this proposed rule change, the Commission in no way minimizes the importance of compliance with CHX rules and all other rules subject to the imposition of fines under the MRP. The Commission believes that the violation of any self-regulatory organization's rules, as well as Commission rules, is a serious matter. However, the MRP provides a reasonable means of addressing rule violations that do not rise to the level of requiring formal disciplinary proceedings, while providing greater flexibility in handling certain violations. The Commission expects that CHX will continue to conduct surveillance with due diligence and make a determination based on its findings, on a case-by-case basis, whether a fine of more or less than the recommended amount is appropriate for a violation under the MRP or whether a violation requires formal disciplinary action under CHX Article 12.

¹¹ 17 CFR 240.19d-1(c)(2).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act¹² and Rule 19d-1(c)(2) under the Act,¹³ that the proposed rule change (SR-CHX-2011-07) be, and hereby is, approved and declared effective.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Cathy H. Ahn
Deputy Secretary

¹² 15 U.S.C. 78s(b)(2).

¹³ 17 CFR 240.19d-1(c)(2).

¹⁴ 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(44).