

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65354; File No. SR-CHX-2011-29)

September 19, 2011

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change to Change the Status of Exchange-Registered Institutional Broker Firms

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 September 14, 2011, the Chicago Stock Exchange, Inc. (“CHX” or the “Exchange”) 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

CHX proposes to amend its rules regarding Exchange-registered Institutional Broker firms to clarify their status. The text of this proposed rule change is available on the Exchange’s website at (www.chx.com) 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 Changes

In its filing with the Commission, the CHX included statements concerning the purpose of and basis for the proposed rule changes 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

1. Purpose

The Exchange is proposing to add Interpretation and Policy .04 to Article 17, Rule 3 to clarify the status of Exchange-registered Institutional Broker firms (“Institutional Brokers”) as not operating on the Exchange. By this proposal, the Exchange believes that it will enable existing and new Institutional Broker firms to engage in trading activities in a less restrictive manner than is currently the case. The Exchange is also proposing to delete Article 20, Rule 7 (Clearing the Matching System) since that requirement is predicated on Institutional Brokers being considered as operating on the Exchange. Notwithstanding this redefinition of the status of Institutional Brokers, the Exchange continues to believe that a separate pricing schedule for orders submitted by Institutional Brokers for execution and/or submission for clearance and settlement is appropriate and represents an equitable allocation of fees for Exchange Participants.

Institutional Brokers are an elective sub-category of Exchange Participants requiring registration with the Exchange. In addition to the other provisions of Exchange rules, Institutional Brokers are subject to the obligations of Article 17 of the CHX rules. Institutional Broker firms typically provide manual 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. This model was eliminated as part of the implementation of Regulation NMS and Exchange’s transition to its New Trading Model, which features an electronic limit order matching system as its core trading facility.³ The Commission’s order approving the Exchange’s New Trading Model noted, “Institutional brokers

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

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 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.”⁴ Although an Institutional Broker has traditionally been deemed to be operating on the Exchange, due to certain changes in their function the CHX is proposing to treat Institutional Brokers as no longer operating on the Exchange. As such, an order that is sent to an Institutional Broker shall not be deemed to be “on the Exchange” unless and until such order is entered into the Exchange’s Matching System.

New Interpretation and Policy .04 to Rule 3 of Article 17 would define an Institutional Broker firm as a CHX Participant firm which voluntarily elects to register with the Exchange as such, and satisfies the Exchange’s requirements as set forth in Article 17. Under the current proposal, an Institutional Broker firm shall not be regarded as operating on the Exchange.⁵ Until fairly recently, Institutional Brokers were permitted to execute trades outside the Exchange’s core trading facility, the Matching System, while still considered to be on the Exchange. Utilizing a functionality known as the Validated Cross, Institutional Brokers were able to execute cross transactions based upon the state of the national market and orders residing in the Matching System at the time the parties agreed to the execution, rather than as of the entry of all essential terms into the electronic systems used by Institutional Brokers to handle and execute such transactions.⁶ In December 2010, however, the Exchange eliminated the Validated Cross

⁴ Id., Section II.C. Institutional Brokers.

⁵ Orders submitted by Institutional Brokers to the CHX’s Matching System would be regarded as being on the Exchange.

⁶ See, e.g., CHX Market Regulation Department Information Memorandum MR-07-9 (Dec, 6, 2007).

functionality and ability of Institutional Brokers to execute transactions on the CHX otherwise than through the Matching System.⁷ Given this change, there is no longer any meaningful reason to treat Institutional Brokers as operating on the Exchange and the proposed Interpretation and Policy .04 reflects that determination. The Exchange is also proposing to delete certain references to Institutional Brokers and/or their activity as being “on the Exchange” in Article 11, Rule 3(e) and in Article 17, Rule 3(a) and in Interpretation and Policy .01 thereto.⁸

The Exchange is further proposing to delete Article 20, Rule 7 (Clearing the Matching System), which requires Institutional Brokers to attempt to execute trades on the Exchange before routing the order to another destination, except if the Institutional Broker is trading for its own account or its customer specifically requests otherwise. Given that Institutional Brokers will no longer be treated as operating on Exchange, the CHX does not believe that these restrictions are appropriate. Broker-dealers which are not part of our facilities should have the freedom to route orders to any destination.⁹ Consequently, we are proposing to delete these requirements from our rules.

Pursuant to this proposal, an Institutional Broker would not be considered as operating on the Exchange and its trading activity within the Matching System would be treated the same as any other order sending Participant which is not registered as an Institutional Broker, except as to

⁷ See Securities Exchange Act Rel. No. 63564 (Dec. 16, 2010), 75 FR 80870 (Dec. 23, 2010) (SR-CHX-2010-25).

⁸ In Article 11, Rule 3(e), we have added language requiring that Institutional Brokers and Market Makers be registered with the Exchange for the provisions to be applicable.

⁹ Such ability to route orders to any market center is also consistent with CHX Article 9, Rule 24 which states “No rule, stated policy or practice of this exchange shall prohibit or condition, or be construed to prohibit, condition or otherwise limit, directly or indirectly, the ability of any Participant to effect any transaction otherwise than on this exchange in any reported security listed and registered on this exchange or as to which unlisted trading privileges on this exchange have been extended which is not a covered security.”

fees as discussed below. Currently, Institutional Brokers are not permitted to execute transactions directly in the over-the-counter (“OTC”) marketplace since they are regarded as being part of the Exchange’s trading facilities.¹⁰ Since the proposed Interpretation and Policy would define Institutional Brokers as being “off-Exchange,” those restrictions would no longer exist and Institutional Brokers would be permitted to execute trades directly in the OTC marketplace, subject to the rules of the appropriate self-regulatory organization (“SRO”).¹¹ Accordingly, the Exchange is proposing to clarify in Article 17, Rule 1 that Institutional Brokers can effect transactions on the Exchange and in other market centers since Institutional Brokers will no longer be deemed to be operating on the Exchange.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general,¹² and furthers the objectives of Section 6(b)(5) in particular,¹³ 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 redefining Institutional Brokers as no longer operating on the Exchange. With the repeal of the Validated Cross functionality and rules, there is no longer any reason to treat Institutional Brokers as trading directly from the Exchange’s facilities. The proposed redefinition of the role of Institutional Brokers properly aligns our rules with the current operation of those firms and will permit them to more effectively compete with other broker-

¹⁰ See CHX Market Regulation Department Information Memorandum MR-11-09 (July 14, 2011), available on the Exchange’s public website, <http://www.chx.com>.

¹¹ Currently, the SRO for the OTC marketplace is FINRA.

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

dealers and serve the interests of their customers and investors. The elimination of the requirement of Institutional Brokers to clear the Matching System before sending customer orders to other trading centers will likewise assist them in competing with other broker-dealers in a free and open market, and will allow them to better serve the interests of their customers and investors.

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act¹⁴ in general, and furthers the objectives of Section 6(b)(4) of the Act¹⁵ in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and other persons using any facility or system which the Exchange operates or controls by continuing to provide for separate billing rates for transactions executed or handled by an Institutional Broker. The Exchange currently assesses separate fees and charges for transactions which are submitted to the CHX by Institutional Brokers.¹⁶ These fees are charged to the Participant firm in whose name the transactions are submitted for clearance and settlement. Typically, the Institutional Broker acts as agent for the Participant or for a correspondent thereof if the Participant is a clearing firm. In general, the fee rates associated with transactions submitted through an Institutional Broker may be higher than other transactions submitted directly into the Matching System, although there is a ceiling or cap for such charges which may make the overall fee lower in some circumstances. Despite the reclassification of Institutional Brokers as “off-Exchange,” the CHX continues to believe that the separate billing structure for transactions submitted through an Institutional Broker is appropriate and represents an equitable allocation of fees to Participants.

¹⁴ 15 U.S.C. 78f.

¹⁵ 15 U.S.C. 78f(b)(4)

¹⁶ See CHX Fee Schedule, Sections E.3. and E.7.

The Exchange provides trading and support technology services to Institutional Brokers without separate charges in order to facilitate their transactions on and through the Exchange. For example, the Exchange makes the Brokerplex[®] order management and recordation system available to Institutional Brokers without charge.¹⁷ Brokerplex is used by Institutional Brokers to receive, transmit and hold orders from their clients while seeking execution within the CHX Matching System or elsewhere in the National Market System. Reports of orders, including the terms of any executions thereof, submitted via Brokerplex are kept by the system. The Exchange also provides operational and back office support services to Institutional Brokers using Brokerplex to handle orders and execute transactions on the Exchange. Finally, the Exchange expends a significant amount of its regulatory resources policing the activities of Institutional Brokers. The separate fee structure for orders submitted through Institutional Brokers helps offset these expenses. The Exchange also provides a credit in its Fee Schedule to Institutional Brokers in their monthly billings based upon a percentage of revenue generated to the Exchange as a result of transactions submitted by that Institutional Broker. This arrangement benefits the Exchange by incenting Institutional Brokers to register with the CHX under Article 17 and direct orders to the Exchange for execution.

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

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

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.

¹⁷ Use of the Brokerplex system satisfies the requirement that Institutional Brokers handle orders within an integrated electronic system. Article 17, Rule 3.b.

III. Date of Effectiveness of the Proposed Rule Changes 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 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 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. Please include File Number SR-CHX-2011-29 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CHX-2011-29. 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 the 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-2011-29 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Elizabeth M. Murphy
Secretary

¹⁸ 17 CFR 200.30-3(a)(12).