

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54185; File No. SR-CHX-2005-34)

July 20, 2006

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Regarding Cancellation of the Stock Leg of a Stock-Option Order

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 November 14, 2005, the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CHX. On July 11, 2006, the Exchange submitted Amendment No. 1 to the proposed rule change.³ 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 Substance of the Proposed Rule Change

The Exchange proposes to amend its rules to permit cancellation of the stock leg of a stock-option order if market conditions in a non-Exchange market prevent the options leg of the order from being executed at the agreed-upon price.

The text of the proposed rule change is available on CHX’s Web site (www.chx.com), at the CHX’s Office of the Secretary, and at the Commission’s public reference room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, CHX made minor revisions to the proposed rule text and clarified certain details of its proposal.

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 on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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

According to the Exchange, stock-option orders are relied on frequently by options market makers as part of their legitimate hedging strategies. The typical stock-option order involves an order to buy or sell a stated number of shares of an underlying security, coupled with the purchase or sale of option contracts, puts or calls on the opposite side of the market from the underlying security.

Certain CHX floor participants receive stock-option related order flow from off-floor participants who are options market makers on options exchanges such as the Chicago Board Options Exchange (“CBOE”). Specifically, the stock leg of a stock-option order is routed to the CHX for execution, while the options leg(s) is executed on an options exchange.

The CHX states that, because stock-option orders are complex transactions (often with multiple parties) and markets are volatile, with quotations moving quickly and often, many times the options leg of the transaction does not occur, in which case the off-floor participant requests that the CHX floor participant cancel the transaction’s stock leg. The proposed rule change would permit cancellation of the stock leg of a stock-option order if market conditions in the

non-Exchange market prevented the execution of the options leg of a transaction.⁴ The proposed rule is based on (and virtually identical to) CBOE Rule 6.48(b)(ii), which permits cancellation of the options leg of a stock-option order.⁵

It is important to note that the proposed rule change would require that the CHX floor participant maintain records “sufficient to establish that market conditions in a non-Exchange market prevented the execution of the option leg(s).” The CHX believes this requirement would give the CHX Department of Market Regulation the ability to oversee the cancellation of stock leg orders, to ensure against abusive trade reporting practices.⁶

⁴ The types of market conditions that would be sufficient to justify cancellation of the Exchange leg of a multi-market order include a sudden change in the price of the options involved in the transaction prior to execution of the trade and a trading halt or systems failure that precludes immediate execution of the options leg at the agreed upon price.

⁵ According to CHX, the stock leg of a stock-option order is always presented to the CHX with an identified buyer and seller who have agreed to the terms of the trade. Both buyer and seller are aware of the possibility that the stock leg of a stock-option order may be cancelled on the CHX if the corresponding options leg is cancelled on an options market. The CHX states that, because both the buyer and seller would be identified when the stock leg is presented to the CHX, there would be no possibility that another CHX member’s order could be matched against a stock-option order. Accordingly, the CHX believes that there would be no risk that an investor’s order could be involuntarily cancelled without notice to the investor; the CHX thus believes that this pattern and practice amply satisfies the requirements of proposed Interpretation and Policy .01(d).

⁶ The recordkeeping requirement would permit the CHX Department of Market Regulation to monitor patterns that may develop, as well as the overall quantity of trade cancellations, to help deter members from simply canceling orders for the sake of convenience. The Exchange believes that the recordkeeping requirement would help ensure that the volume of transactions reported is accurate and complete and not overstated.

2. Statutory Basis

The Exchange believes that its proposal, as amended, is consistent with Section 6(b) of the Act⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act⁸ in particular, 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 by promoting consistency between the Exchange and options markets relating to cancellation of the components of stock-option orders.

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

The Exchange does not believe that the proposed rule change, as amended, would impose any 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 CHX consents, the Commission will:

- A. by order approve such proposed rule change, as amended; or

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

- 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-2005-34 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CHX-2005-34. 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 Room. 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 publicly available. All submissions should refer to File Number SR-CHX-2005-34 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.⁹

Nancy M. Morris
Secretary

⁹ 17 CFR 200.30-3(a)(12).