

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65633; File No. SR-CHX-2011-29)

October 26, 2011

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

I. Introduction

On September 14, 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 to change the status of Exchange-registered Institutional Broker firms (“Institutional Brokers”). The proposed rule change was published for comment in the Federal Register on September 26, 2011.³ The Commission received no comment letters on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

Institutional Brokers are an elective sub-category of Exchange Participants who are subject to the obligations of Article 17 of the CHX rules. Typically, Institutional Brokers provide manual order handling and execution services for other broker-dealers or institutional clients. Institutional Brokers are the successors to the floor brokers that operated within the Exchange’s previous floor-based, auction trading model. That model was eliminated as part of the Exchange’s transition to its New Trading Model, which features an electronic limit order

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 65354 (September 19, 2011), 76 FR 59476 (“Notice”).

matching system as its core trading facility.⁴ In approving the Exchange's New Trading Model, the Commission stated:

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 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.⁵

Due to certain changes in the function of Institutional Brokers,⁶ CHX proposes to treat Institutional Brokers as no longer always operating on the Exchange. Pursuant to CHX's proposal, an order that is sent to an Institutional Broker shall not be deemed to be "on the Exchange" unless and until the Institutional Broker enters it into the Exchange's Matching

⁴ The Exchange replaced its traditional auction marketplace with its New Trading Model beginning in 2006. See Securities Exchange Act Release No. 54550 (September 29, 2006), 71 FR 59563 (October 10, 2006) (SR-CHX-2006-05).

⁵ Id. 71 FR at 59567.

⁶ Until fairly recently, CHX permitted Institutional Brokers to execute trades outside the Exchange's core trading facility, the Matching System, and those trades were still considered to be on the Exchange. Utilizing a functionality known as the Validated Cross, Institutional Brokers executed 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. See, e.g., CHX Market Regulation Department Information Memorandum MR-07-9 (December 6, 2007). In December 2010, the Exchange eliminated the Validated Cross functionality and ability of Institutional Brokers to execute transactions on the CHX otherwise than through the Matching System. See Securities Exchange Act Release No. 63564 (December 16, 2010), 75 FR 80870 (December 23, 2010) (SR-CHX-2010-25). Given this change, the Exchange states 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. See Notice, 76 FR at 59477.

System.⁷ Correspondingly, the Exchange proposes 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.

The Exchange also proposes 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. Currently, Institutional Brokers are not permitted to execute transactions directly in the over-the-counter (“OTC”) marketplace because, as discussed above, orders directed to them are deemed on the Exchange.⁸ In light of the proposed elimination of the on-Exchange designation of all Institutional Broker orders, CHX also proposes to modify Article 17, Rule 1 to permit Institutional Brokers to effect transactions both on the Exchange and in other market centers, which would include the OTC marketplace, subject to the rules of the appropriate self-regulatory organization (“SRO”).⁹

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁰ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,¹¹ in that it is designed to promote just and equitable principles of trade, to foster cooperation

⁷ See New Interpretation and Policy .04 to Rule 3 of Article 17.

⁸ See CHX Market Regulation Department Information Memorandum MR-11-09 (July 14, 2011), available on the Exchange’s public website, <http://www.chx.com>.

⁹ Currently, the SRO for the OTC marketplace is FINRA.

¹⁰ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹¹ 15 U.S.C. 78f(b)(5).

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.

The Commission notes that, due to the elimination of the Validated Cross functionality, an Institutional Broker can only execute an order on the Exchange by submitting an order into the Matching System, which is the means all other Exchange participants execute orders on the Exchange.¹² The Commission believes that it is appropriate and consistent with the Act for Institutional Brokers to no longer be deemed to be a participant operating on the Exchange, and that a customer order received by an Institutional Broker should not be deemed to be on the Exchange unless and until such order is entered into the Matching System. Allowing an Institutional Broker to execute transactions other than on the Exchange and eliminating the requirement to clear the Matching System before sending customer orders to other trading centers, should permit an Institutional Broker to more effectively compete with other broker-dealers and serve the interests of their customers and investors.¹³

¹² See supra note 6.

¹³ The Commission notes that it approved separately changes to CHX's rules governing the clearing of Institutional Brokers' transactions effected other than on CHX. See Securities Exchange Act Release No. 65615 (October 24, 2011) (SR-CHX-2010-17).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-CHX-2011-29) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

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Deputy Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).