

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53949; File No. SR-CHX-2006-04)

June 6, 2006

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of a Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to the Transfer of Securities Among Co-Specialists Within a Specialist Firm

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 8, 2006, 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 May 3, 2006, CHX filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On May 22, 2006, CHX filed Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested parties.

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

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

<sup>3</sup> In Amendment No. 1, the Exchange revised the rule text of the proposed rule change to clarify the application of the proposal to intrafirm transfers and revised the purpose section to discuss the proposed provision requiring the specialist unit to accurately represent its plans in the specialist application regarding designating a particular co-specialist to trade a security.

<sup>4</sup> In Amendment No. 2, the Exchange revised the rule text of the proposed rule change to clarify the impact of an intrafirm transfer on the deregistration and registration of individual co-specialists within a specialist firm and made non-substantive changes to the proposed rule text. The proposed rule text set forth in Amendment No. 2 superceded and replaced the rule text set forth in the initial filing and Amendment No. 1 in its entirety.

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

The CHX proposes to amend its rules to permit the transfer of securities to different co-specialists within a specialist firm. Below is the text of the proposed rule change, as amended.

Proposed new language is underlined;<sup>5</sup> proposed deletions are in [brackets].

**ARTICLE XXX**

**Specialists**

**Registration and Appointment**

RULE 1. No Participant shall act as a specialist or co-specialist on the Exchange in any security unless registered as such in the particular security. Except for the intrafirm transfers of registration permitted by Section I.2 of Interpretation and Policy .01 of this Rule, [R]registration as either a specialist or co-specialist shall be subject to the approval of the Exchange.

\* \* \*

An applicant for initial registration as a co-specialist shall, or as otherwise may be determined by the Committee on Specialist Assignment and Evaluation be required to serve for a period of six months in the capacity of relief specialist under continuous supervision of a registered co-specialist. No application for co-specialist in a particular issue will be considered by the Committee on Specialist Assignment and Evaluation (and no intrafirm transfer permitted by Section I.2 of Interpretation and Policy .01 of this Rule may be made) prior to the time that the individual has satisfied these training requirements.

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<sup>5</sup> The Exchange inadvertently failed to designate the phrase “as either a specialist or co-specialist” in the first paragraph of CHX Rule 1 as proposed new text. For clarity, the new text has been underlined herein. The Exchange has committed to file an amendment reflecting the fact that this phrase is new text prior to Commission approval of the proposed rule change.

\* \* \*

Unless required by [Subject to] the provisions of Article XXX, Rule 8 or when permitted by Section I.2 of Interpretation and Policy .01 of this Rule, a specialist, co-specialist or relief specialist shall not relinquish their positions until permission to do so is received from the Committee on Specialist Assignment and Evaluation.

• • • **Interpretations and Policies:**

**.01 COMMITTEE ON SPECIALIST ASSIGNMENT AND EVALUATION**

ASSIGNMENT FUNCTION

I. EVENTS LEADING TO ASSIGNMENT PROCEEDINGS

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1. No change.
2. Specialist Request. Any specialist unit and co-specialist may ask to be deregistered in one or more of its assigned securities, and the Committee on Specialist Assignment and Evaluation (the Committee) will hear all such requests. The Committee will initiate a reassignment proceeding if it believes that such action is called for. The Committee may initiate a reassignment proceeding on the basis that if the merits of the request are not established the security must be retained by the registered specialist if no other unit appears to be able to make a better market or if no other unit applies.

\* \* \*

**Exception.** Intrafirm transfers that meet the criteria below do not require the submission of an application or the approval of the Committee and will not result in a proceeding by the Committee to reassign the security to another co-specialist or specialist firm.

Because a specialist unit is responsible both financially and as a regulatory matter for the activities of its co-specialists, a specialist unit might, from time to time, determine that the responsibility for trading one or more securities should be transferred from one co-specialist to another within the same specialist unit. Without seeking prior Committee approval, a specialist unit may transfer the responsibility for trading securities among the co-specialists associated with its firm, so long as (1) the specialist unit immediately notifies the Exchange, in the manner required by the Exchange, of each such transfer; and (2) when such a transfer is made within six months of an initial assignment of the security to the specialist unit, the specialist unit must inform the Exchange, in writing, of its reasons for making the change. Each such transfer by the specialist unit effectively deregisters a co-specialist in the securities that the co-specialist no longer trades and registers another co-specialist in any newly-assigned securities.

[Without limiting the foregoing, the Committee will generally approve a co-specialist's request for deregistration in any security for the purpose of having the security assigned to another co-specialist in the same specialist unit only under the following conditions:]

[(a) For any security awarded to such co-specialist in competition, a period of at least two years must have elapsed from the date of the original assignment. Alternatively, if the specialist unit agrees to have the security posted, a period of at least one year (but less than two years) must have elapsed from the date of the original assignment.]

[(b) For any security awarded to such co-specialist without competition, no minimum time period is required.]

3. No change.

4. Split-Up and/or Merger of Specialist Units.

(a) No change.

(b) When a security is to be assigned or reassigned, specialists, not co-specialists, apply for registration. Article XXX, Rule 1.01.II. In applying for registration in a particular stock, however, a specialist must indicate the individual co-specialist who will trade the stock. Article XXX, Rule 1.01.III. Therefore, although the Committee assigns a stock to a specialist unit, not to the co-specialist, and the specialist is responsible both financially and as a regulatory matter for the activities of its co-specialists, it is the trading activities of the co-specialist that are the basis for the Committee's evaluations. Thus, a specialist and co-specialist are jointly responsible for each assignment and, with the exception of an intrafirm transfer permitted by Section I.2 of Interpretation and Policy .01 of this Rule, a withdrawal of either party may require a new posting if circumstances warrant.

(c) Because the specialist is financially responsible for the activities of its co-specialists, a co-specialist may act as such only with the concurrence of the specialist. If, at any time, a specialist no longer wants a co-specialist to trade for it, the specialist -- subject to the Committee's approval -- may terminate the relationship. Similarly, a co-specialist -- again subject to the Committee's approval -- may terminate his relationship with a specialist. With the exception of an intrafirm transfer permitted by Section I.2 of Interpretation and Policy .01 of this Rule, either of the decisions described above are subject to the Committee's approval.

When the Committee assesses a situation involving the split-up or merger of specialist units, [Among the factors] the Committee may consider a number of factors, including [are]:

1. co-specialist performance.
2. specialist capital generally.
3. specialist capital made available to the particular co-specialist.
4. length of association between specialist and co-specialist.

5. length of time that the co-specialist has traded the security.

6[5]. whether the co-specialist has a proprietary interest in the trading profits or losses derived from the stock.

7[6]. whether the specialist or co-specialist wishes to continue trading the security.

8[7]. performance of the proposed new co-specialist.

9[8]. financial capacity of the co-specialist's new specialist unit.

Based on its consideration of these and any other relevant factors, the Committee will decide whether to (i) leave a security with the specialist, (ii) permit the co-specialist to take the security with him, or (iii) require a new posting. In the event of a posting, the existing specialist or co-specialist will be permitted to reapply for the stock. A decision to permit the specialist or co-specialist to retain the security may be made conditionally based on the performance of the new co-specialist or specialist.

As noted above, intrafirm transfers that meet the criteria set out in Section I.2 of Interpretation and Policy .01 of this Rule do not require the approval of the Committee and will not result in a proceeding by the Committee to reassign the security to another co-specialist or specialist firm.

5. - 8. No change.

## II. ASSIGNMENT PROCEDURES

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The assignment procedures set out in this Section II do not apply to the intrafirm transfers permitted by Section I.2 of Interpretation and Policy .01 of this Rule. Intrafirm transfers that meet the criteria set out in Section I.2 of Interpretation and Policy .01 of this Rule do not require the submission of an application or the approval of the Committee.

In assigning specialists, co-specialists, relief specialists and odd-lot dealers, the Committee may act through a Subcommittee of not less than three of its members, at least one of whom shall not be affiliated with a broker/dealer. Where emergency circumstances require the expedited assignments of one or more specialists, co-specialists, relief specialists or odd-lot dealers, and a Subcommittee is unable to be convened, the chairman, or a member of the Committee designated by the chairman, may make such temporary assignment as he deems necessary, pending a final determination by a Subcommittee or the full Committee. Any proposal or agreement between or among specialists, co-specialists, relief specialists or odd-lot dealers, to exchange existing assignments, shall be submitted in writing to the Subcommittee for its consideration and, if not disapproved by the Subcommittee within 30 days of the date of submission, shall become effective as written.

1. Applications. In applying, a specialist unit should state the reasons why it believes the stock should be assigned to it. A standard application form is available from the Exchange and should be used for this purpose. Except as otherwise provided in paragraph 6, below, the application must, at a minimum, include the name and background of the co-specialist who will normally be trading the security and his ability and experience relative to the issue being applied for. It is important that the application accurately represent the specialist unit's plans as to the co-specialist who will trade the security. Also, if any special or unique characteristics of the security have been identified by the Committee, such as unusually high capital requirements or institutional participation making trading difficult, the applicant should specifically note and comment on its ability to deal with the special characteristics.

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### III. GUIDELINES FOR ASSIGNMENT OF ISSUES TO CO-SPECIALISTS

The guidelines set out in this Section III apply to the assignment of securities by the Committee. These guidelines do not apply to the intrafirm transfers permitted by Section I.2 of Interpretation and Policy .01 of this Rule. Intrafirm transfers that meet the criteria set out in Section I.2 of Interpretation and Policy .01 of this Rule do not require the submission of an application or the approval of the Committee.

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3. Because the Committee considers the demonstrated ability and experience of the co-specialist designated by the specialist unit when applying for the assignment of a security, it is important that the specialist unit accurately represent its plans for having that particular co-specialist trade the security. A specialist unit must not designate a co-specialist with relatively strong demonstrated ability and experience when applying for a security and then immediately transfer the security to a co-specialist with less demonstrated ability and experience without good cause for making the change.

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## 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, as amended, and discussed any comments it received regarding the proposal, as amended. 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.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

Under the Exchange's current rules relating to the assignment of securities to specialist



firms, the Committee on Specialist Assignment and Evaluation (“CSAE”) assigns each security to a specialist firm and this firm is responsible both financially and as a regulatory matter for the trading of the security.<sup>6</sup> At the same time, however, when a specialist firm applies to trade a security, it must identify the co-specialist that will trade the security and the CSAE will review the co-specialist’s trading performance in making its assignment decision.<sup>7</sup> As an overall matter, the specialist firm and the individual co-specialist are jointly responsible for each assigned security and the decision by either the firm or the individual trader to deregister in a security could result in the posting of the security for re-assignment.<sup>8</sup>

Several specialist firms have expressed interest in being able to transfer assigned securities among co-specialists within each firm. These types of transfers might be used, for example, when a particular security becomes more active than originally envisioned and could be better handled by a more experienced trader. Under the existing rules relating to the assignment of securities, however, intrafirm transfers are not particularly favored. In fact, the Exchange’s rules typically require the co-specialist to whom a security was assigned in competition to keep the assigned stock for a period of two years.<sup>9</sup>

Through this submission, the Exchange seeks to amend its rules to permit the transfer of securities among co-specialists within a firm, without seeking prior Committee approval, so long as: (1) the specialist unit immediately notifies the Exchange of such transfer; and (2) when such a

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<sup>6</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Section II, Introductory paragraphs; and Section I.4.

<sup>7</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Sections II and III.

<sup>8</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Section I.4. Telephone conversation between Ellen Neely, President and General Counsel, CHX and David Michehl, Special Counsel, Division of Market Regulation, Commission on May 26, 2006.

<sup>9</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Section I.2. Securities assigned without competition may be transferred without a waiting period, but these transfers must be approved by the CSAE.

transfer is made within six months of an initial assignment of the security to the specialist unit, the specialist unit provides written notification to the Exchange of the transfer decision and of its reasons for making the change.<sup>10</sup> Each intrafirm transfer by the specialist unit effectively deregisters a co-specialist in the securities that the co-specialist no longer trades and registers another co-specialist in any newly-assigned securities.<sup>11</sup> The Exchange believes that these changes will permit a specialist firm to have an appropriate amount of flexibility to respond to a variety of issues, including changes in the volatility of a particular security and the co-specialist's ability to trade assigned securities.<sup>12</sup>

Under the Exchange's existing rules, when the CSAE makes a decision to assign a particular security, the CSAE considers the qualifications of the specialist unit and the co-specialist's demonstrated ability and experience. Because the CSAE bases its decision, in part, on a co-specialist's qualifications, it is important that a specialist firm accurately represent its plans for having a particular co-specialist trade a security. A specialist unit must not designate a co-specialist with relatively strong demonstrated ability and experience when applying for a security and then immediately transfer the security to a co-specialist with less demonstrated ability and experience without good cause for making the change.

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act<sup>13</sup> in that it would promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national

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<sup>10</sup> See supra note 4.

<sup>11</sup> Id.

<sup>12</sup> The Exchange represents that these proposed rules are similar to provisions that are in place at the New York Stock Exchange. See NYSE Rule 103B, Section IV.

<sup>13</sup> 15 U.S.C. 78f(b)(4).

market system, and, in general, protect investors and the public interest by permitting specialist firms to respond to various issues that may arise by transferring securities among co-specialists within the firm.

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

The Exchange does not believe that the proposed rule change, as amended, will 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 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 self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, as amended; or
- B. institute proceedings to determine whether the proposed rule change, as amended, 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, as amended, 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 Number SR-CHX-2006-04 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-2006-04. 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 CHX. 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-2006-04 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.<sup>14</sup>

Nancy M. Morris  
Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).