

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54191; File No. SR-CHX-2006-04)

July 21, 2006

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Granting Approval to a Proposed Rule Change and Amendment Nos. 1, 2 and 3 Thereto Relating to the Transfer of Securities Among Co-Specialists Within a Specialist Firm

On March 8, 2006, the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change to amend its rules to permit the transfer of securities to different co-specialists within a specialist firm. 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 proposed rule change, as amended, was published for comment in the Federal Register on June 15, 2006.<sup>5</sup> On July 3, 2006, CHX filed Amendment No. 3 to the proposed rule change.<sup>6</sup> The Commission received

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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 The proposed rule text set forth in Amendment No. 2 superceded and replaced the rule text set forth in the initial filing and Amendment No. 1 in its entirety.

<sup>5</sup> See Securities Exchange Act Release No. 53949 (June 6, 2006), 71 FR 34648.

<sup>6</sup> In Amendment No. 3, the Exchange makes minor, non-substantive changes to the rule text of the proposed rule change. This is a technical amendment and is not subject to notice and comment.

no comments regarding the proposal, as amended. This order approves the proposed rule change, as amended.

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>7</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>8</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>9</sup>

The current Exchange rules generally require that a co-specialist to whom a security was assigned in competition to keep the assigned security for a period of two years.<sup>10</sup> Alternatively, if the specialist unit agrees to have the security posted, a period of at least one year must have elapsed from the date of the original assignment.<sup>11</sup> Further, securities assigned without competition may be transferred without a waiting period. However, in all situations, the transfers must be approved by the CSAE.<sup>12</sup>

The Exchange proposes to delete the waiting period requirement prior to approving a

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<sup>7</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Section II, Introductory paragraphs; and Section I.4.

<sup>8</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Sections II and III.

<sup>9</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Section I.4.

<sup>10</sup> See Article XXX, Rule 1, Interpretation and Policy .01, Section I.2.

<sup>11</sup> Id.

<sup>12</sup> Id.

request for deregistration and to permit the transfer of securities among co-specialists within a firm, without seeking prior CSAE approval, as long as: (1) the specialist unit immediately notifies the Exchange of 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 provides written notification to the Exchange of the transfer decision and of its reasons for making the change. Accordingly, each intrafirm transfer by the specialist unit effectively would deregister a co-specialist in the securities that the co-specialist no longer trades and register another co-specialist in any newly-assigned securities.

In addition, 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, the Exchange proposes to make explicit in its rules that it is important that a specialist firm accurately represent plans for having a particular co-specialist trade a security. Under the proposal, 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.

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>13</sup> In particular, the Commission believes that the proposal, as amended, is consistent with Section 6(b)(5) of the Act, which requires that the rules of an exchange be

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<sup>13</sup> In approving this proposed rule change, as amended, 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).

designed to promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national market system, and, in general, protect investors and the public interest. The Commission believes that the proposed rule change, as amended, is designed to provide specialist firms with greater flexibility to respond to various market conditions that may require prompt transfer of securities among co-specialists within the same firm. With respect to the Exchange's proposal to require that a specialist unit 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, the Commission believes that this requirement is designed to provide the CSAE with accurate and complete information at the time it makes specialist assignment decisions and to protect the integrity of the specialist assignment process.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-CHX-2006-04), as amended, is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).