

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54198; File No. SR-CHX-2005-01)

July 24, 2006

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 Relating to the Exchange's Order Priority Rule and the Mandatory Use of Order Match Functionalities

I. Introduction

On February 3, 2005, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange"), filed with the Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² to amend Exchange Article XXX, Rule 2 to clarify the requirements of the Exchange's priority rule and to require specialists to make use of Exchange-provided order match functionalities except in limited circumstances. On September 16, 2005 and October 6, 2005, the Exchange filed Amendment Nos. 1 and 2, respectively, to the proposed rule change. The proposed rule change, as amended, was published for comment in the Federal Register on October 28, 2005.³ The Commission received no comments on the proposal. On July 13, 2006, the Exchange filed Amendment No. 3.⁴ This order approves the proposed rule change, as amended by Amendment

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 52647 (October 21, 2005), 70 FR 62152 ("Notice").

⁴ See Partial Amendment dated July 13, 2006 ("Amendment No. 3"). The text of Amendment No. 3 is available on the Exchange's Web site (http://www.chx.com/rules/proposed_rules.htm), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

Nos. 1, 2, and 3, grants accelerated approval to Amendment No. 3, and solicits comments on Amendment No. 3.

II. Description

The Exchange proposes to amend Exchange Article XXX, Rule 2, to clarify the requirements of the Exchange's priority rule and to require specialists to make use of Exchange-provided order match functionalities except in limited circumstances. The Exchange's priority rule generally requires Exchange specialists to give precedence to orders in their books for the purchase or sale of securities over their own dealer (proprietary) orders.⁵

The Exchange's systems incorporate order match functionalities that are designed to replace proposed specialist proprietary orders with eligible customer orders in the specialist's book. These order match functionalities, among other things, prevent a specialist from manually executing a proprietary order when there is a customer order on the same side on the book that is eligible for execution. The proposed rule change would require specialists to use the order match functionalities except when there are system problems with the order match functionalities,⁶ and in certain circumstances related to the execution of preopening orders pursuant to the Exchange's

⁵ See Exchange Article XXX, Rule 2, Precedence to Orders in Book. Specialists, however, are not required to give precedence to certain professional orders.

⁶ The Exchange stated that it does not anticipate that systems problems will occur frequently, but has included this exception to the rule to address those relatively rare circumstances when the order match functionality is not operating properly due to unexpected consequences of unrelated systems changes or a software failure. The Exchange stated that it did not intend the exception to allow participants to avoid the use of order match functionalities, but to recognize that there could be limited circumstances when the order match functionalities are malfunctioning.

rules,⁷ or related to satisfaction through ITS of a trade through of a customer order.⁸

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 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-2005-01 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CHX-2005-01. 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

⁷ See Exchange Article XXX, Rule 37(a)(4). In Amendment No. 3, the Exchange clarified that this proposed exception only applies to listed securities.

⁸ In addition, in Amendment No. 3, the Exchange eliminated the proposed exception that when a specialist received an inbound ITS execution in satisfaction of a complaint lodged by an Exchange specialist against another market center, the specialist would not be required fill any other customer order(s) in his or its book as a result of having received the "satisfying" ITS execution. In Amendment No. 3, the Exchange revised the rule text to clarify that when a specialist receives an inbound ITS execution in satisfaction of another market center's trade-through of a customer order that the specialist has already filled, the specialist, under current Exchange rules, is required to give the customer order

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 available publicly. All submissions should refer to Amendment No. 3 of File Number SR-CHX-2005-01 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of Section 6 of the Act⁹ and the rules and regulations thereunder applicable to a national securities exchange.¹⁰ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹¹ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove

that was traded through by the other ITS market center any better price that the specialists receives in satisfaction of the trade-through.

⁹ 15 U.S.C. 78f.

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

¹¹ 15 U.S.C. 78f(b)(5).

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.

The Commission believes that the proposed change to clarify the requirements of the Exchange's priority rule is designed to provide both investors and specialists with a better understanding of a specialist's obligations. The Commission further believes that the proposed change to require specialists to make use of order match functionalities, except under limited circumstances, could prevent potential trading ahead violations from occurring by ensuring that eligible orders on the book are executed in place of the specialist's proprietary interest.

The Commission finds good cause for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after publishing notice of Amendment No. 3 in the Federal Register pursuant to Section 19(b)(2) of the Act.¹² The Commission believes that the changes proposed in Amendment No. 3 clarify the application of the Exchange's priority rule and proposed exception to the requirement to use order match functionalities. Further, the Commission believes the proposal in Amendment No. 3 to eliminate one of the exceptions proposed in the Notice reflects the specialist's obligations under the Exchange's rules.

¹² 15 U.S.C 78s(b)(2). Pursuant to Section 19(b)(2) of the Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-CHX-2005-01), as amended by Amendment Nos. 1, 2, and 3, is hereby approved, and that Amendment No. 3 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Nancy M. Morris
Secretary

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).