

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-66177; File No. SR-CHX-2012-02)

January 18, 2012

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change to Add to and Amend its Rules Regarding the Obligations of Institutional Brokers Registered with the Exchange

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 January 6, 2012, the Chicago Stock Exchange, Inc. (“CHX” or the “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

CHX proposes to amend Interpretation and Policy .02 to Article 17, Rule 1 regarding the registration of Institutional Brokers, amend Article 17, Rule 3 regarding the obligations of Institutional Brokers, add Article 17, Rule 6 regarding information barrier procedures between Institutional Broker and non-Institutional Broker units of the same broker-dealer and make various typographical and clarifying changes throughout its rules. The text of this proposed rule change is available on the Exchange’s website at ([www.chx.com](http://www.chx.com)) and in the Commission’s Public Reference Room.

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

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

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 changes and discussed any comments it received regarding the proposal. 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

The Exchange is proposing various rule amendments and additions to permit broker-dealers registered as Institutional Brokers with the CHX to operate a non-Institutional Broker unit within the same Participant Firm. The Exchange proposes to amend Interpretation and Policy .02 to Article 17, Rule 1 (Registration and Appointment of Institutional Brokers) to clarify that an Institutional Broker Representative (“IBR”) shall be considered those individual persons who accept orders, enter bids and offers and execute transactions on behalf of an Institutional Broker and are registered with the Exchange as an IBR. Subject to compliance with proposed new Rule 6 of Article 17, the amended Interpretation and Policy provides that the responsibilities and duties of Institutional Brokers as provided for in Article 17, Rule 3 (Obligations), Article 21, Rule 6 (Submission of Clearing Information for Transactions Executed Off-Exchange) and Article 9, Rule 14 (Reporting Riskless Principal Transactions) would be limited to the activities of individuals designated as an IBR of firms registered as Institutional Brokers, and clerks assigned thereto. The amended interpretation would specify that only registered IBRs may act on behalf of Institutional Brokers in making clearing submissions pursuant to Article 21, Rule 6,

submitting Benchmark orders to the Exchange pursuant to Article 20, Rule 4.b.(2), or entering Riskless Principal trading reports pursuant to Article 9, Rule 14. The Exchange seeks to amend Article 17, Rule 3(e) to clarify the recordkeeping obligations owed by Institutional Brokers. The Exchange proposes to add Article 17, Rule 6 creating requirements for information barrier procedures between Institutional Broker and non-Institutional Broker units of the same broker-dealer. Finally, the Exchange seeks to make typographical and ministerial changes throughout its rules regarding various references to Institutional Brokers.

Institutional Brokers are an elective sub-category of Exchange Participants requiring registration with the Exchange. Registration as an Institutional Broker is limited to Participant Firms, and is not available to individual persons.<sup>3</sup> Currently, each individual person authorized to enter bids and offers and execute transactions on behalf of an Institutional Broker is considered an IBR and must be registered with the Exchange as provided in Article 6. Institutional Brokers were formerly regarded as operating on the facilities of the Exchange. This view was a carryover from the Exchange's former floor-based, auction trading model pursuant to which such firms were registered as floor brokers.<sup>4</sup> Moreover, the Exchange formerly offered a trade reporting functionality to Institutional Brokers which permitted them to execute trades outside the Matching System and still be considered as executed on the Exchange. With the elimination of that functionality in December 2010, there was no longer any compelling rationale to regard Institutional Brokers as operating on the Exchange.<sup>5</sup> Subsequently, the Exchange

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<sup>3</sup> Article 17, Rule 1, Interpretation and Policy .02.

<sup>4</sup> The Exchange replaced its traditional auction marketplace with its New Trading Model beginning in late 2006. See Securities Exchange Act Rel. No. 54550 (Sept. 29, 2006), 71 FR 59563 (Oct. 10, 2006) (SR-CHX-2006-05).

<sup>5</sup> See Securities Exchange Act Rel. No. 63564 (Dec. 16, 2010), 75 FR 80870 (Dec. 23, 2010) (SR-CHX-2010-25).

adopted an Interpretation and Policy providing that Institutional Brokers were no longer considered to be operating on the Exchange.<sup>6</sup>

Given this change in the status of Institutional Brokers, the Exchange believes that some existing and potential Institutional Brokers may wish to engage in other business activities beyond that handled by IBRs, such as over-the-counter (“OTC”) market making. The intent of this proposal is to afford such firms the ability to engage in non-Institutional Broker activities, while ensuring that their activities as an Institutional Broker are appropriately governed by CHX rules.<sup>7</sup>

The Exchange proposes to modify the provisions of Interpretation and Policy .02 to Article 17, Rule 1 to define an IBR as an individual person affiliated with an Institutional Broker who is authorized to accept orders, enter bids and offers and execute transactions on behalf of an Institutional Broker and who has registered with the Exchange as an IBR as provided in Article 6.<sup>8</sup> The Exchange also proposes to add a definition of IBR to Article 1, Rule 1 (Definitions) for the sake of clarity. The Exchange further proposes to add language to the definition of “Participant” in Article 1, Rule 1(s) to facilitate and account for the limitation of the obligations of Institutional Brokers to the activities of the newly-defined IBRs. Only registered IBRs are permitted to use Exchange systems provided for Institutional Brokers for handling orders and

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<sup>6</sup> See Securities Exchange Act Rel. No. 65633 (Oct. 26, 2011), 76 FR 67509 (Nov. 1, 2011) (SR-CHX-2011-29).

<sup>7</sup> The OTC market making activity of such firms would presumably be subject to existing FINRA rules applicable to such activity.

<sup>8</sup> Among other things, all applicants seeking to register as Institutional Broker Representatives must successfully complete an Institutional Broker exam. Article 6, Rule 3, Interpretation and Policy .01(a).

reporting transactions.<sup>9</sup> The Exchange proposes to add text in Article 17, Rule 2 designed to clarify that only Participants Firms are eligible to register as Institutional Brokers.

Through this proposal, the Exchange proposes to amend its rules to clarify that certain enumerated obligations of Institutional Brokers should be restricted to the activities of IBRs. The responsibilities and duties as provided for in Article 17, Rule 3 (Obligations), Article 21, Rule 6 (Submission of Clearing Information for Transactions Executed Off-Exchange) and Article 9, Rule 14 (Reporting Riskless Principal Transactions) would apply to the activities of those individuals registered with the Exchange as IBRs, and clerks thereto.<sup>10</sup> Only registered IBRs (and their clerks) would be permitted to act on behalf of Institutional Brokers in making clearing submissions pursuant to Article 21, Rule 6, submitting Benchmark orders pursuant to Article 20, Rule 4.b.(2) or entering Riskless Principal trading reports pursuant to Article 9, Rule 14.

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<sup>9</sup> The Exchange provides the Brokerplex<sup>®</sup> trading system for use by IBRs in conducting their business. Brokerplex is an order and trade entry, recordation and management system developed and operated by the CHX for use by IBRs to receive, transmit and hold orders from their clients while seeking execution within the CHX Matching System or elsewhere in the National Market System. Brokerplex can be used to record trade executions and send transaction reports to a Trade Reporting Facility (“TRF”), as defined in FINRA Rules 6300 *et seq.*, as amended from time-to-time. Brokerplex can also be used by Institutional Brokers to initiate clearing submissions to a Qualified Clearing Agency via the Exchange’s reporting systems. See Article 21, Rule 6 (Submission of Clearing Information for Transactions Executed Off-Exchange). The Exchange currently restricts Brokerplex use to registered IBRs and would continue to do so.

<sup>10</sup> Article 17, Rule 3 sets forth the substantive obligations owed by Institutional Brokers registered with the Exchange pursuant to Article 17, Rule 1. These obligations include the entry of orders into an automated system, handling of orders within an integrated system, maintenance of specific trading accounts, certain defined obligations in handling and executing orders, and maintenance of certain records. Article 21, Rule 6 authorizes Institutional Brokers to make clearing submissions into the Exchange’s systems for certain non-CHX trades. Article 9, Rule 14 specifies the manner in which Participants may report riskless principal transactions to the Exchange.

The Exchange believes that it is appropriate to make an IBR's status as such contingent on registration with Exchange. A Participant's status as an Institutional Broker is voluntary and requires registration with the Exchange, which is consistent with the current proposal related to IBRs.<sup>11</sup> The proposed interpretation would permit firms registered as Institutional Brokers to designate certain individuals as IBRs, while employing other individuals in separate, non-IBR capacities.<sup>12</sup> In this manner, firms which wish to conduct a portion of their business as an Institutional Broker, but also engage in other activities may do so without subjecting those other areas to those provisions of the CHX rules specifically applicable to Institutional Brokers. The Exchange believes that the proposed changes would permit Institutional Brokers to carry out a multifaceted business strategy, while still ensuring that the activities of those persons acting as IBRs are subject to the appropriate regulatory provisions. The proposed amendment to Interpretation and Policy .02 of Article 17, Rule 1 is consistent with the effective operation and regulation of Institutional Brokers and IBRs.

Pursuant to the proposed amendment to Interpretation and Policy .02, a firm registered with the Exchange as Institutional Broker could maintain other lines of business separate and distinct from its Institutional Broker activities without subjecting those other areas to the requirements of Article 17, Rule 3 contingent upon the creation and maintenance of effective information barrier procedures as specified in proposed Rule 6 of Article 17. The responsibilities and duties of Article 17, Rule 3 are closely tailored to the historical activities of individuals operating as IBRs. The Exchange does not believe that there is any particular need to

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<sup>11</sup> See Article 17, Rule 3, Interpretation and Policy .04.

<sup>12</sup> For example, a firm could organize itself to have one business unit consisting of IBRs sending orders to the Exchange and other trading centers for execution, and facilitating non-CHX clearing submissions pursuant to Article 21, Rule 6 and separately maintain another business unit chiefly engaged in OTC market making.

extend the reach of those obligations to the activities of individuals who are not acting in the capacity of an IBR. Non-IBR activities of a Participant firm registered as an Institutional Broker would, of course, remain subject to all other applicable provisions of the Exchange's rules. The non-IBR personnel at a Institutional Broker could continue to send orders to the Exchange; however, those orders would be regarded as standard order-sending Participant orders, and not as Institutional Broker activity. The Exchange can and will distinguish between orders sent to the Matching System by IBRs and other orders sent by Institutional Brokers to the Matching System for billing and other purposes.

Orders and other activity sent to the Exchange by non-IBR affiliated persons of an Institutional Broker would be subject to the provisions of Section E.1. of the CHX Fee Schedule applicable to most Participants, and would not be billed as Institutional Broker activity pursuant to Section E.3. of the Fee Schedule. Firms registered as Institutional Brokers would only receive a credit pursuant to the provisions of Section F.2. of the Fee Schedule for the trading activity of registered IBRs.<sup>13</sup> Firms registered as Institutional Brokers would remain subject to the obligations of Article 17, Rule 3, Article 21, Rule 6, and Article 9, Rule 14 as to the activities of those individuals associated with the firm and registered as an IBR. The Exchange believes that this treatment of Institutional Broker activity appropriately recognizes that firms registered as Institutional Brokers may engage in other activities which should not be judged by the specific standards devised for Institutional Broker activity.

The limitation that only IBRs could act on behalf of Institutional Brokers in making clearing submissions pursuant to Article 21, Rule 6, entering Benchmark orders pursuant to Article 20, Rule 4.b.(2) and reporting Riskless Principal transactions pursuant to Article 9, Rule

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<sup>13</sup> The Exchange plans to propose changes to its Fee Schedule to make explicit this billing structure.

14 is consistent with the above-described limitations, since the ability to make such clearing submissions is restricted to IBRs using Brokerplex and the rationale for making riskless principal trade reports to the Exchange is to facilitate the entry of clearing submissions pursuant to Article 21, Rule 6. The Exchange also proposes to modify the text of Article 17, Rule 5(a) to clarify in that rule that the ability to make clearing submissions is limited to IBRs. Since the entry of Benchmark orders to the Exchange for execution is limited to Institutional Brokers, the Exchange believes that such orders should only be submitted by CHX-registered IBRs.<sup>14</sup>

The Exchange proposes to amend Article 17, Rule 3(e) to clarify that the obligations owed by Institutional Brokers under Article 11 are not limited simply to the maintenance of certain required records, but also include the affirmative provision of electronic information to the Exchange in certain circumstances. Article 11, Rule 3(b) requires Institutional Brokers to provide specified information in an electronic format to the Exchange about orders accepted and handled by those firms. Article 11, Rule 4 requires that Institutional Brokers provide electronic records of trade executions received in other, non-CHX trading centers. The provision of trading data by Institutional Brokers in an electronic format is designed to facilitate the creation of automated surveillance reports run by the CHX's Market Regulation Department in furtherance of the Exchange's obligation to oversee trading activity of its Institutional Brokers.

As noted above, the proposed changes to Interpretation and Policy .02 to Article 17, Rule 1 provide that the proposed limitation of the obligations of Institutional Brokers to the activities of its IBRs is contingent upon the creation and maintenance of effective information barrier procedures between the Institutional Broker and non-Institutional Broker units. The Exchange

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<sup>14</sup> The Exchange also proposes to delete the reference in the Benchmark order definitions in both Article 20 and Article 1, Rule 2 to the Trading Phase Date of Reg NMS, since the Reg NMS rules were implemented a number of years ago.

proposes to add Rule 6 (Non-Institutional Broker Unit; Information Barriers) to Article 17 to define the specific information barrier requirements for that purpose. A multi-unit Institutional Broker would be required to establish and maintain information barriers between the Institutional Broker unit and non-Institutional Broker unit. Such information barriers will be required to be reasonably designed to prevent the Institutional Broker unit from having knowledge of unexecuted customer orders in possession of the non-Institutional Broker unit and likewise prevent the non-Institutional Broker unit from having knowledge of unexecuted customer orders in the possession of the Institutional Broker unit. The Institutional Broker unit may, however, transmit an order to the non-Institutional Broker unit of the firm for purposes of handling and executing the order, and the non-Institutional Broker unit may likewise transmit an order to the Institutional Broker unit.

At the time an Institutional Broker wished to set up a non-Institutional Broker unit within the firm, it would be required to submit to the Exchange its Written Supervisory Procedures (“WSPs”) as they pertain to these information barrier procedures. At minimum, the WSPs will have to satisfactorily address (1) the manner in which the firm will satisfy the requirements of this rule (including the compliance and audit procedures it proposes to implement to ensure that the information barrier is maintained); and (2) identify the names and titles of the person or persons responsible for maintenance, supervision and surveillance of the procedures. The Exchange’s existing rules require Institutional Brokers to provide the Exchange with such information and reports relating to its transactions as the Exchange may request.<sup>15</sup> The Exchange expects Institutional Brokers to take appropriate remedial action against any person violating this rule or the Institutional Broker's internal compliance and audit procedures as a part

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<sup>15</sup> Article 6, Rules 7 (Providing Information) and 9 (Provision of Information to the Exchange) and Article 11, Rule 1 (Furnishing of Records).

of their existing supervisory responsibilities, as well as recognizing that the Exchange may take appropriate remedial action for any such violation.

In addition, the proposed rule provides that the firm's WSPs must describe the internal controls that the Institutional Broker will implement to satisfy each of the conditions stated in the rule, and the compliance and audit procedures proposed to implement and ensure that the controls are maintained. If the Exchange determined that the organizational structure and the compliance and audit procedures proposed by the Institutional Broker are acceptable, the Exchange would so inform the Institutional Broker, in writing. Unless the Exchange finds that an Institutional Broker's information barrier procedures are acceptable, all activities of an Institutional Broker (including those of a non-IBR) will be subject to the obligations placed upon an Institutional Broker as provided in the Exchange's rules.

The Exchange believes that the provisions regarding the information barrier procedures of new Rule 6 of Article 17 are sufficient to address the issues presented by the operation of a non-Institutional Broker unit within a firm which is an Exchange-registered Institutional Broker. The CHX understands that the non-Institutional Broker unit of such firms will largely function in a similar manner to other order sending firms which are not registered with the Exchange as an Institutional Broker pursuant to our rules. The Exchange believes that the information barrier procedures of proposed Rule 6 are adequate to provide a meaningful separation of the Institutional Broker and non-Institutional Broker units.

The Exchange is proposing an Interpretation and Policy to define the elements of an adequate information barrier procedure for purposes of new Rule 6. Proposed Interpretation and Policy .01 defines an "information barrier" as an organizational structure in which the Institutional Broker functions are conducted in a physical location separate from the locations in

which the non-Institutional Broker activities are conducted. The Institutional Broker and non-Institutional Broker units should not use trading or order management systems which permit them to share information about orders or transactions being handled by each respective unit. However, upon request and not on his or her own initiative, an Institutional Broker Representative may furnish to persons at the same firm or an affiliated firm (“affiliated persons”), the same sort of market information that the Institutional Broker would make available in the normal course of its Institutional Broker activity to any other person. The Institutional Broker Representative must provide such information to affiliated persons in the same manner that he or she would make such information available to a non-affiliated person. An individual person may not simultaneously act as an Institutional Broker Representative and as a representative of the non-Institutional Broker unit. The Exchange believes that the information barrier requirements as set forth in the proposed Interpretation and Policy are reasonable and appropriate given the nature of the relationship between the Institutional Broker and non-Institutional Broker units. The CHX further believes that the articulation of these standards in the proposed Interpretation and Policy will provide clarity and direction to interested Institutional Brokers in creating their information barrier procedures.

Finally, the Exchange seeks to make typographical and clarifying changes throughout its rules regarding various references to Institutional Brokers by capitalizing that phrase throughout to distinguish the rights and obligations of CHX-registered Institutional Brokers from other Participants which may be colloquially or informally referred to as institutional brokers. The Exchange proposes to make an addition to Article 17, Rule 1 to clarify that Institutional Brokers may only use those Exchange systems which the Exchange has designated for their use.<sup>16</sup> The

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<sup>16</sup> Currently, those systems are limited to the Brokerplex order entry, management and

Exchange also proposes to delete the reference in Article 15, Rule 1 to proceedings based upon the refusal of an Institutional Broker or Market Maker to register. As this filing clarifies, registration as either an Institutional Broker or Market Maker is voluntary act and the failure to register does not represent a violation of any Exchange rule or interpretation.<sup>17</sup>

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general,<sup>18</sup> and furthers the objectives of Section 6(b)(5) in particular,<sup>19</sup> in that it is designed to promote just and equitable principles of trade, to foster cooperation 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 proposed stated interpretation clarifies that the CHX will regard the responsibilities and duties of Institutional Brokers set forth in the specified rules as applying only to the activities of Institutional Broker Representatives, and their clerks. The proposed changes would facilitate the operation of firms which wish to conduct as portion of their business as an Institutional Broker, but also engage in other activities (such as OTC market making) without subjecting those other areas to those provisions of the CHX rules and Fee Schedule specifically applicable to the activities of Institutional Brokers. The Exchange believes that the proposed changes would permit Institutional Brokers to carry out a multifaceted business strategy, while still ensuring that the activities of those persons acting as IBRs are subject to the appropriate fees and

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recordation system.

<sup>17</sup> Registration as an IBR under Article 17 or a Market Maker Trader under Article 16 is likewise elective. An Institutional Broker would be deemed to have violated CHX rules, however, if it gave unauthorized access to Exchange systems designated for use by an IBR to non-IBRs (other than clerks thereto).

<sup>18</sup> 15 U.S.C. 78f(b).

<sup>19</sup> 15 U.S.C. 78f(b)(5).

regulatory obligations. The Exchange believes that such an interpretation promotes just and equitable principles of trade because it appropriately limits the application of those rules governing the obligations and permitted activities of Institutional Brokers to the activities of those individuals acting in the capacity of an IBR.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments Regarding 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 45 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 or disapprove such proposed rule change, or
- 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](mailto:rule-comments@sec.gov). Please include File Number SR-CHX-2012-02 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CHX-2012-02. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the 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 File Number SR-CHX-2012-02 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).