

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51692; File No. SR-CHX-2005-04)

May 12, 2005

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto, to Clarify that Specialists May Not Charge Commissions with Respect to the Execution of CHXpress Orders

On March 1, 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 its rules to clarify that a CHX specialist is not permitted to charge a commission for the execution of CHXpress™ orders. On March 21, 2005 and March 30, 2005, the Exchange filed Amendment Nos. 1 and 2, respectively, to the proposal. The proposed rule change, as amended, was published for comment in the Federal Register on April 7, 2005.³ The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

The Exchange is rolling out a new, automated functionality, CHXpress, which, according to the Exchange, is designed to provide additional opportunities for the Exchange’s participants to seek and receive liquidity through automated executions of orders at the Exchange.⁴ With a few exceptions, CHXpress orders will be executed immediately and automatically against same or better-priced orders in the specialist’s book, or against the specialist’s quote (when CHXpress

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 51465 (April 1, 2005), 70 FR 17743.

⁴ See Securities Exchange Act Release No. 50481 (September 30, 2004); 69 FR 60197 (October 7, 2004) (SR-CHX-2004-12).

is available).⁵ If a CHXpress order cannot be immediately executed, it will be placed in the specialist's book for display or later execution.⁶ The handling of CHXpress orders within the Exchange's systems is entirely automatic. CHX specialists do not provide CHXpress orders with the execution guarantees that might otherwise be available to agency limit orders,⁷ and CHX specialists also would not be required to seek liquidity for CHXpress orders in other markets. This proposal clarifies that a CHX specialist would not be permitted to charge a commission in connection with the execution of a CHXpress order.

The Commission has reviewed carefully the proposed rule change, as amended, and finds that it is consistent with the requirements of Section 6 of the Act⁸ and the rules and regulations thereunder applicable to a national securities exchange.⁹ In particular, the Commission finds that

⁵ See CHX Article XX, Rule 37(b)(11)(C).

⁶ A CHXpress order will be instantaneously and automatically displayed when it constitutes the best bid or offer in the CHX book. See CHX Article XX, Rule 37(b)(11)(D).

⁷ See CHX Article XX, Rule 37(b)(11)(E)-(F).

⁸ 15 U.S.C. 78f.

⁹ 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). The Commission notes that it previously approved similar proposed rule changes filed by the New York Stock Exchange, Inc. ("NYSE") to prohibit a specialist on the NYSE from charging "floor brokerage" (i.e., a commission imposed on exchange floor brokers) for the execution of an order received by the specialist via the NYSE's automated order routing system, known as SuperDot. See Securities Exchange Act Release Nos. 42727 (April 27, 2000), 65 FR 26258 (May 5, 2000); 42694 (April 17, 2000), 65 FR 24245 (April 25, 2000); and 42184 (November 30, 1999), 64 FR 68710 (December 8, 1999). In addition, the Commission recently approved a proposed rule change submitted by the Chicago Board Options Exchange ("CBOE") to prohibit Designated Primary Market Makers ("DPMs") from charging a brokerage commission for an order, or the portion of an order: (i) for which the DPM was not the executing broker, which includes any portion of the order that is automatically executed through a CBOE system; (ii) that is automatically cancelled; or (iii) that is not executed, and not cancelled. See Securities Exchange Act Release No. 51235 (February 22, 2005), 70 FR 9687 (February 28, 2005).

the proposed rule change is consistent with Sections 6(b)(5) and 6(e)(1) of the Act,¹⁰ because it is designed to promote just and equitable principles of trade, to remove 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; and is not designed to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members. The Commission also believes that the proposed rule change is consistent with Section 11(A)(a)(1)(C) of the Act,¹¹ which states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure, among other things, economically efficient execution of securities transactions, and fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets.

The Commission believes that the Exchange's proposal is consistent with Section 6(e) of the Act.¹² Section 6(e) of the Act¹³ was adopted by Congress in 1975 to statutorily prohibit the fixed minimum commission rate system. As noted in a report of the House of Representatives, one of the purposes of the legislation was to "reverse the industry practice of charging fixed rates of commissions for transactions on the securities exchanges."¹⁴ The fixed minimum commission rate system allowed exchanges to set minimum commission rates that their members had to charge their customers, but allowed members to charge more. CHX's proposal, by contrast, does

¹⁰ 15 U.S.C. 78f(b)(5) and 78f(e)(1).

¹¹ 15 U.S.C. 78k-1(a)(1)(C).

¹² 15 U.S.C. 78f(e).

¹³ Id.

¹⁴ H.R. Rep. No. 94-123, 94th Cong., 1st Sess. 42 (1975).

not establish a minimum commission rate, but instead prohibits commissions in circumstances in which the CHX specialist does not handle the order. Accordingly, the Commission does not believe that the Exchange's proposal to limit the fees charged by CHX specialists constitutes fixing commissions, allowances, discounts, or other fees for purposes of Section 6(e)(1) of the Act.¹⁵

In addition, the Commission believes that the Exchange's proposal is reasonable because it prohibits a CHX specialist from charging a commission for an order executed without assistance or handling by the CHX specialist. In this regard, the Commission notes that it has not viewed a self-regulatory organization's limits on fees that its members may charge, even when a member acts as agent, as inconsistent with Section 6(e) of the Act.¹⁶ In addition, the Exchange's limits on fees that CHX specialists may charge applies only to members who choose to be specialists on the Exchange. Therefore, CHX is not fixing fees generally; it is merely imposing a condition, which is consistent with the Act, on a member's appointment as a specialist.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Sections 6(b)(5) and 6(e)(1) of the Act.¹⁷

¹⁵ 15 U.S.C. 78f(e)(1).

¹⁶ 15 U.S.C. 78f(e)(1).

¹⁷ 15 U.S.C. 78f(b)(5) and 78f(e)(1).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-CHX-2005-04), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Margaret H. McFarland
Deputy Secretary

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).