

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51967; File No. SR-CHX-2004-25)

July 1, 2005

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to a Prohibition on Using a Layoff Service Unless The Service Provides Required Information to The Exchange

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 31, 2004, 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 June 7, 2005 and June 27, 2005, the Exchange filed Amendment Nos. 1³ and 2⁴ to the proposed rule change, respectively. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend CHX Article V, Rule 4 to prohibit Exchange participants, beginning August 1, 2005, from using any communications means to send orders to another market for execution (“layoff service”), unless that layoff service has established a

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Amendment No. 1 dated June 7, 2005. In Amendment No. 1, the Exchange modified the text of the proposed rule change in response to comments by the Commission staff. See infra notes 12-16 and accompanying text for a description of items included in Amendment No. 1.

⁴ See Amendment No. 2 dated June 27, 2005, replacing the original filing and Amendment No. 1 in their entirety. In Amendment No. 2, the Exchange eliminated the requirement to provide information about the contra party to the execution and made other technical changes to the proposal.

process for providing the Exchange with specific information about the orders and the executions that participants receive. The text of the proposed rule change, as amended, is available on CHX's Web site (http://www.chx.com/marketreg/proposed_rules.htm), at CHX's principal office, and at the Commission's Public Reference Room.

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 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 Changes

1. Purpose

The Exchange's participants execute trades on the Exchange and on other markets. Most interaction with other markets occurs through electronic systems that are provided either by other markets themselves or by members of those markets. Although the Exchange currently receives execution information about its participants' trading in other markets, the Exchange believes that it could conduct more efficient surveillance of its participants' order-handling activities if it received additional types of information.

This proposal, which would amend the Exchange's rule relating to communications from the trading floor, is designed to provide the Exchange with the layoff service information that it needs to enhance its surveillance programs. Specifically, the proposal would prohibit Exchange participants, beginning August 1, 2005, from using a layoff service to send orders to another

market for execution, unless that service (or the participant using the service) has established a process for providing the Exchange with the following specific information: (1) the symbol of the security to be traded; (2) the clearing organization; (3) an order identifier that uniquely identifies the order; (4) the participant recording the order details; (5) the number of shares; (6) the side of the market on which the order is placed; (7) a designation of the order type (e.g., market, limit, stop, stop limit); (8) whether the order is for the account of a customer or for the account of the participant sending the order; (9) whether the order is short or short exempt; (10) any limit price and/or stop price; (11) the date and time of order transmission; (12) the market to which the order was transmitted; (13) the time in force; (14) a designation of the order as held or not held; (15) any special conditions or instructions associated with the order (including any customer do-not-display instructions or all-or-none conditions); (16) any modifications to the details set out in (1) through (15), for all or part of an order or any cancellation of all or part of the order; (17) the date and time of the transmission of any modifications to the order or any cancellation of the order; (18) the date and time of any order expiration; (19) the identification of the party canceling or modifying the order; (20) the transaction price; (21) the number of shares executed; (22) the date and time of execution; (23) settlement instructions; (24) a system-generated time(s) of recording the required information; and (25) any other information that the Exchange may require from time to time.⁵ For purposes of this proposal, an “order” would be defined as any written, oral or electronic instruction to effect a transaction.⁶

⁵ See Proposed CHX Article V, Rule 4, Interpretation and Policy .01.

⁶ See Proposed CHX Article V, Rule 4, Interpretation and Policy .03.

Other provisions of the proposal would set out additional requirements that are designed to ensure that the Exchange receives uniformly-presented, useful data.⁷ For example, the Exchange proposes that all information be provided on a real-time basis and in an electronic format acceptable to the Exchange.⁸ Moreover, each layoff service would be required to synchronize its business clocks with reference to a time source designated by the Exchange and maintain that synchronization following procedures prescribed by the Exchange.⁹ The Exchange confirms in another provision that all time references be expressed in terms of hours, minutes, and seconds.¹⁰

Furthermore, the Exchange confirms that a violation of these new requirements would be considered conduct inconsistent with just and equitable principles of trade, in violation of CHX Article VIII, Rule 7.¹¹ Therefore, these violations would not be eligible for handling under the Exchange's Minor Rule Violation Plan.

The Exchange submitted Amendment No. 1 to require that participants provide additional information about their layoff activity;¹² to replace references to the Exchange's "members" with references to its "participants," reflecting changes in terminology associated with the Exchange's

⁷ As an administrative matter, the proposal also would delete CHX Article V, Rule 5, which applied to wires from the Exchange's floor to its branch offices. The Exchange represents that it no longer maintains branch offices and has no purpose for keeping this rule in place.

⁸ See Proposed CHX Article V, Rule 4, Interpretation and Policy .01.

⁹ See Proposed CHX Article V, Rule 4, Interpretation and Policy .02.

¹⁰ See Proposed CHX Article V, Rule 4, Interpretation and Policy .03.

¹¹ See Proposed CHX Article V, Rule 4, Interpretation and Policy .04.

¹² See Amendment No. 1, supra note 3. Among other things, the Exchange added requirements that participants confirm whether an order was for the account of a customer or for the account of the participant sending the order to the other market; whether an order was short or short exempt; the market to which the order was

February 2005 demutualization;¹³ to require that participants notify the Exchange before using an alternative or additional layoff vendor;¹⁴ and to confirm that these rules would not replace any record retention obligations to which the Exchange's participants would be subject under the Act and the rules thereunder.¹⁵ Other changes proposed in Amendment No. 1 clarify the application of the rule text and make other minor corrections to the text.¹⁶ Amendment No. 2 eliminated one proposed field of data relating to the contra party to an execution and corrected a few typographical errors.¹⁷

As noted above, the Exchange believes that this proposal would enhance the Exchange's ability to review its members' order-handling activities and to determine their compliance with applicable trading rules. Moreover, the Exchange believes that this proposal is consistent with recommendations made by the independent consultant retained by the Exchange under its recent settlement agreement with the Commission.¹⁸

transmitted; the identification of any party canceling or modifying the order; the date and time of any order expiration; and the contra party to the execution (if applicable).

¹³ See Securities Exchange Act Release No. 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005).

¹⁴ See Proposed CHX Article V, Rule 4, Interpretation and Policy .05.

¹⁵ See Proposed CHX Article V, Rule 4, Interpretation and Policy .06.

¹⁶ For example, the Exchange had mistakenly identified the proposed rule change as occurring in CHX Article VI, not in CHX Article V.

¹⁷ See Amendment No. 2, *supra* note 4.

¹⁸ See Securities Exchange Act Release No. 48566 (September 30, 2003) (Administrative Proceeding File No. 3-11282), available at <http://www.sec.gov/litigation/admin/34-48566.htm>.

2. Statutory Basis

The Exchange believes that the proposal, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.¹⁹ Specifically, the CHX believes that the proposal, as amended, is consistent with Section 6(b)(5) of the Act,²⁰ in that 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 by permitting the Exchange to require its participants (or their layoff service providers) to provide the Exchange with data necessary to conduct appropriate surveillance of its participants' trading activities.

B. Self-Regulatory Organization's Statement of 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 Regarding the Proposed Rule Changes Received from Members, Participants or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Changes and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such other 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:

¹⁹ 15 U.S.C. 78f(b).

²⁰ 15 U.S.C. 78f(b)(5).

- A. by order approve the proposed rule changes, or
- B. institute proceedings to determine whether the proposed rule changes 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. Please include File Number SR-CHX-2004-25 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File No. SR-CHX-2004-25. 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 changes 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 will also 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 No. SR-CHX-2004-25 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.²¹

Margaret H. McFarland
Deputy Secretary

²¹ 17 CFR 200.30-3(a)(12).