

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52953; File No. SR-CHX-2005-36)

December 14, 2005

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change By The Chicago Stock Exchange, Inc. and Amendment No. 1 Thereto Regarding Trading in Sub-Penny Increments

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 1, 2005, the Chicago Stock Exchange, Inc. (the “CHX” or the “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 December 7, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.³ 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

Through this filing, the Exchange proposes to amend its rules to permit Exchange participants to execute orders in sub-penny increments. The text of this proposed rule change is available on the Exchange’s Web site at http://www.chx.com/rules/proposed_rules.htm, at the Exchange’s principal office, and in the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1)

² 17 CFR 240.19b-4.

³ See Form 19b-4 dated December 7, 2005. (“Amendment No. 1”). In Amendment No. 1, the Exchange: (1) deleted any references to customer orders to make clear that a specialist must not “step ahead” of any order in the book (not just customer orders) by less than \$0.01; (2) deleted a proposed sentence relating to a specialist’s trading in other markets; (3) revised the rule text to confirm the smallest increment (\$0.0001) in which an order may be executed on the Exchange; and (4) made clear that this proposal relates only to the Exchange’s current trading model.

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 Change

1. Purpose

Under the Exchange's existing trading rules, the Exchange's participants may not bid or offer in increments below \$0.01.⁴ Through this filing, the Exchange seeks to permit its participants to execute trades in sub-penny increments and to establish rules that regulate the instances when a specialist may trade in sub-penny increments against incoming orders when there are orders in the specialist's book.⁵

As an initial matter, the proposed rule change would provide that Exchange participants may execute transactions in sub-penny increments.⁶ As noted above, there is not currently an Exchange rule that prohibits this practice, but the Exchange believes it is appropriate to establish that trading in sub-penny increments is specifically permitted. The Exchange believes that it is

⁴ The Exchange does not currently have a rule that sets a minimum increment at which trades can occur. Its rule relating to minimum variations specifically refers to variations at which bids or offers may be made on the Exchange. See Article XX, Rule 22.

⁵ The Exchange intends to file a separate proposal to permit its participants and customers, beginning with the compliance date of Rule 612, to bid or offer in sub-penny increments in Nasdaq/NM securities, when those bids or offers are priced less than \$1.00 per share.

⁶ See proposed Article XX, Rule 22(b).

appropriate to allow its participants to execute transactions in sub-penny increments because other markets permit trading in these increments and the Exchange and its participants would be at a competitive disadvantage if this trading were not permitted.⁷

Additionally, the proposed rule change would provide that an Exchange specialist (or a market maker holding a customer order) may not execute an incoming order in a sub-penny increment that is less than \$0.01 better than a limit order in the specialist's (or market maker's) book. This prohibition on "stepping ahead" of a resting limit order for less than a penny would be expanded from its current scope, which applies only to the trading of Nasdaq/NM securities, to apply to the trading of all securities on the Exchange.⁸ The Exchange believes that this rule, which provides protection to orders in a specialist's book, should be extended to orders in listed

⁷ In addition, although Rule 612 of Regulation NMS specifically prohibits the display, ranking, or acceptance of a bid, offer, or order in sub-penny increments where the bid, offer, or order is priced at or above \$1.00, it does not prohibit trading in sub-penny increments. See 17 CFR 242.612(a). Indeed, the Commission, in the release of the final rules associated with Regulation NMS, noted that "Rule 612 will not prohibit a sub-penny execution resulting from . . . price improvement . . . so long as the execution did not result from an impermissible sub-penny order or quotation." Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37556 (June 29, 2005).

⁸ The Exchange's rule relating to sub-penny trading in Nasdaq/NM securities was first approved in 2001 and has been extended many times. See Securities Exchange Act Release Nos. 44164 (April 6, 2001), 66 FR 19263 (April 13, 2001); 44535 (July 10, 2001), 66 FR 37251 (July 17, 2001) (extending pilot through November 5, 2001); 45062 (November 15, 2001), 66 FR 58768 (November 23, 2001) (extending pilot through January 14, 2002); 45386 (February 1, 2002), 67 FR 6062 (February 8, 2002) (extending the pilot through April 15, 2002); 45755 (April 15, 2002), 67 FR 19607 (April 22, 2002) (extending the pilot through September 30, 2002); 46587 (October 2, 2002), 67 FR 63180 (October 10, 2002) (extending the pilot through January 31, 2003); 47372 (February 14, 2003), 68 FR 8955 (February 26, 2003) (extending the pilot through May 31, 2003); 47951 (May 30, 2003), 68 FR 34448 (June 9, 2003) (extending the pilot through December 1, 2003); 48871 (December 3, 2003), 68 FR 69097 (December 11, 2003) (extending pilot through June 30, 2004); 49994 (July 9, 2004), 69 FR 42486 (July 15, 2004) (extending pilot through June 30, 2005); and 52326 (August 23, 2005), 70 FR 51394 (August 30, 2005).

securities before an Exchange specialist is permitted to provide sub-penny price improvement to an inbound order.

This proposed rule change would apply only in the Exchange's current trading model. Within the current model, an Exchange specialist (or any market maker handling a customer order) typically would provide sub-penny price improvement to an order either on a manual basis or through an automated pricing mechanism used by specialist firms to process orders that are not automatically executed within the Exchange's systems. The Exchange will re-address issues associated with sub-penny trading as part of the filing the Exchange will make to qualify as an "Automated Trading Center" under Regulation NMS.⁹

2. Statutory Basis

The CHX believes the proposal 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).¹⁰ The Exchange believes that the proposed changes are consistent with Section 6(b)(5) of the Act,¹¹ because they would 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 by permitting trading to occur in sub-penny increments on the Exchange while providing protection to customer orders that are accepted or displayed in penny increments.

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

The Exchange does not believe that the proposed rule changes would impose any burden on competition.

⁹ See 17 CFR 242.600(b)(4).

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

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:

- (A) by order approve the 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 proposal, 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 No. SR-CHX-2005-36 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-2005-36. 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 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 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-2005-36 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.¹²

Jonathan G. Katz
Secretary

¹² 17 CFR 200.30-3(a)(12).