

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66391; File No. SR-CHX-2012-05)

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Fee Schedule to Implement a Clearing Submission Fee Credit for Institutional Brokers

February 14, 2012

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 February 2, 2012, the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by CHX. CHX has filed the proposal pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(2) thereunder,⁴ which renders the proposal effective upon filing with the Commission. 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 its Fee Schedule, effective February 16, 2012, to amend its Fee Schedule [sic] to implement a Clearing Submission Fee Credit for Institutional Brokers.

The text of this proposed rule change is available on the Exchange’s Web site at www.chx.com and in 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(2).

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 Changes

1. Purpose

Through this filing, the Exchange proposes to amend its Schedule of Fees and Assessments (the “Fee Schedule”), effective February 16, 2012, to create a Clearing Submission Fee Credit to be paid to Institutional Brokers and make other technical changes. In October 2011, the Exchange added Article 21, Rule 6 authorizing the submission by the Exchange of non-CHX trades entered through an Institutional Broker to a Qualified Clearing Agency for clearance and settlement.⁵ Among other things, the Exchange imposes a Trade Processing Fee on the Clearing Participants named in these clearing submissions, pursuant to the provisions of Section E.7. of the Fee Schedule. In November 2011, the Exchange modified the definition of the Trade Processing Fee to be based upon non-CHX executed trades for which clearing information is entered by an Exchange-registered Institutional Broker into the Exchange’s systems and submitted to a Qualified Clearing Agency pursuant to Article 21, Rule 6(a).⁶ The Exchange now proposes to rename the Trade Processing Fee as the “Clearing Submission Fee” for purposes of clarity and institute a Clearing Submission Fee Credit to share the revenue

⁵ See, Securities Exchange Act Release No. 65615 (Oct. 24, 2011), 76 FR 67239 (Oct. 31, 2011) (SR-CHX-2011-17). Currently, the National Securities Clearing Corporation (“NSCC”) is the Qualified Clearing Agency for such transactions.

⁶ See, Securities Exchange Act Release No. 65792 (Nov. 18, 2011), 76 FR 72739 (Nov. 25, 2011) (SR-CHX-2011-31).

generated by these fees and incentivize this activity by its Institutional Brokers.⁷ The Exchange previously had in place a Trade Processing Fee Credit beginning in August 2008 through April 2011, but repealed it pending the adoption of Article 21, Rule 6.⁸ With the implementation of that rule, the Exchange proposes to reinstate the credit formerly paid to Institutional Brokers regarding clearing submissions for non-CHX trades, albeit at a different rate than previously.⁹

The Exchange proposes to pay on a monthly basis a credit equal to 8% of the Clearing Submission Fees collected by the Exchange pursuant to Section E.7. of the Fee Schedule to the Institutional Broker which acted as the broker for the ultimate Clearing Participant to the clearing submission (known as the “Clearing Broker”).¹⁰ The Exchange believes that payment of a Clearing Submission Fee Credit to the Clearing Broker based on activity handled by it will incent Institutional Brokers to utilize the Exchange’s systems and services in forwarding non-

⁷ The Exchange is also proposing to add text to Section E.3.a. of the Fee Schedule to emphasize that the fees imposed pursuant to that section are for trades executed in the Matching System and to distinguish that activity from transactions subject to Section E.7. of the Fee Schedule.

⁸ See, Securities Exchange Act Release No. 58362, 73 FR 49511 (SR-CHX-2008-13) (Aug. 14, 2008) (adopting a Trade Processing Fee Credit); Securities Exchange Act Release No. 60259 (July 7, 2009), 74 FR 34062 (July 14, 2009) (SR-CHX-2009-08) (changes to calculation and allocation of Trade Processing Fee Credits paid to Institutional Brokers); Securities Exchange Act Release No. 64173 (April 4, 2011), 76 FR 19818 (April 8, 2011) (SR-CHX-2011-02) (repealing Trade Processing Fee Credit).

⁹ At the time it was repealed, the Trade Processing Fee Credit was set at the same rate as the current Transaction fee credit, i.e., 16% of the fee paid by the Clearing Participant to the Exchange in the transaction.

¹⁰ The broker representing the ultimate clearing participant is currently known as the “broker of credit.” Since both that broker and the “originating broker” (defined as the Institutional Broker that executes a trade) can receive a credit, the Exchange believes that it would be more accurate to use the term “Clearing Broker.” The Exchange also proposes to capitalize the terms “Transaction Fee Credit,” “Clearing Broker” and “Originating Broker” in the Fee Schedule to emphasize that those are defined terms. The Exchange notes that it is possible, although not required, for the same Institutional Broker to act as both the Originating Broker and Clearing Broker in any given transaction.

CHX trades to NSCC, rather than using alternative mechanisms such as correspondent clearing or Nasdaq's Automated Confirmation Transaction ("ACT") system. The Exchange proposes to provide a credit equal to 50% of the credit paid to Institutional Broker for transactions handled by it which are executed on the Exchange.¹¹ The Exchange believes that payment of a credit for non-CHX trades at a lower rate than for CHX trades appears to strike an appropriate balance between incentivizing Institutional Brokers to execute trades on the CHX's facilities and competing with other venues to make clearing submissions for trades executed by Institutional Brokers in the over-the-counter ("OTC") marketplace.¹²

Only Institutional Brokers which are members of the Financial Industry Regulatory Authority, Inc. ("FINRA") will be eligible for the Clearing Submission Fee Credit. Since the trading activities involved in the relevant clearing submissions by definition occurred in a market center other than the Exchange (normally the OTC marketplace), the provisions of Exchange Act Section 15(b)(8) are implicated.¹³ Under Section 15(b)(8), a registered broker or dealer must be a member of a securities association registered under Section 15A of the Exchange Act, unless it effects transactions in securities solely on a national securities exchange of which it is a member. Currently, the only registered securities association is FINRA. Since transactions giving rise to a

¹¹ A Transaction Fee Credit of 16% of the Transaction Fees generated pursuant to Section E.3.a. is paid to Institutional Brokers for trades submitted through that firm and which were executed on the Exchange. [sic] Section F.2. of the Fee Schedule. Of that amount, 4% is paid to the Originating Broker and 12% is paid to the Clearing Broker.

¹² The Exchange notes that it is uncertain as to whether the 8% level for the Clearing Submission Fee Credit will ultimately prove to be the correct amount in effectuating its purpose, which is to incent Institutional Brokers to enter clearing submissions for non-CHX trades through the Exchange's system. At some point, the Exchange may seek to raise the 8% level of the Clearing Submission Fee Credit in order to attract business. If so, the Exchange would make the appropriate filing to modify its Fee Schedule as required by the rules of the Commission.

¹³ 15 U.S.C. 78o(b)(8).

Clearing Submission Fee Credit are normally executed in the OTC marketplace, the Exchange proposes to limit the payment of Clearing Submission Fee Credits to Institutional Brokers which are members of FINRA in order to avoid creating a violation of Section 15(b)(8) by the Institutional Brokers receiving such credits.¹⁴

The Exchange recognizes that the Commission has raised concerns about so-called payment for order flow programs in variety of scenarios. For example, the 2007 Report Concerning Examinations of Options Order Routing and Execution stated, “The Commission previously has expressed concern that payment for order flow and internalization in the markets contribute to an environment in which quote competition is not always rewarded, thereby discouraging the display of aggressively priced quotes and impeding investor’s ability to obtain better prices. [footnote omitted]”¹⁵ The Exchange believes that the proposed Clearing Submission Fee Credit materially differs from other programs inasmuch as payment of the credit does not depend on the execution of a trade on the CHX’s facilities and therefore does not discourage aggressive quote competition. Rather, the credit is based on the receipt of a Clearing Submission Fee by the Exchange, which is assessed for the post-execution submission via the

¹⁴ Exchange Act Rule 15b9-1 provides a limited exemption if the broker-dealer carries no customer accounts and has annual gross income derived from purchases and sales of securities otherwise than on a national securities exchange of which it is a member in an amount no greater than \$1,000. 17 CFR 240.15b9-1. Since broker-dealers can separately charge commissions, however, the Exchange will not ordinarily know whether a non-FINRA member has already received more than \$1,000 compensation arising out of OTC transactions as commissions or some other means. The Exchange’s proposed restriction will preclude an Institutional Broker’s violation of these provisions by the receipt of Clearing Submission Fee Credits.

¹⁵ Report Concerning Examinations of Options Order Routing and Execution, U.S. Securities and Exchange Commission (Mar. 8, 2007), p.2.

CHX's systems to NSCC for clearance and settlement.¹⁶ As such, the Exchange does not believe that a payment of a credit for post-trade clearing submissions raises the same execution quality issues which underlie the Commission's stated concerns about payment for order flow programs.

Even taking the view that the Clearing Submission Fee Credit implicates market quality issues, the Exchange notes that a variety of other payment for order flow practices are prevalent in the securities industry. As the Commission has recognized, payment for order flow is not in itself unlawful.¹⁷ For example, many options exchanges have created payment for order flow programs which are reflected in their rules and fee schedules.¹⁸ It is also not uncommon for broker-dealers to "internalize" their order flow by trading as principal with their own clients. The Exchange's goal in creating a Clearing Submission Fee Credit is to incent transaction providers to conduct business using the CHX's systems and services, by which the Exchange can generate revenue. The implementation of a Clearing Submission Fee Credit should further this legitimate objective by encouraging Institutional Brokers to make clearing submissions for non-CHX trades using the Exchange's systems.

¹⁶ See, Article 21, Rule 6 and Securities Exchange Act Release No. 65615, *supra*, note 3. Among other things, the Exchange permits the post-trade substitution of Clearing Participants on a non-CHX trade prior to making the clearing submission. This substitution process is particularly important in facilitating the execution of the equity component of stock-option or stock-futures orders. The Clearing Submission Fee is designed to compensate the Exchange for the costs of providing the systems used, and oversight of, such activities.

¹⁷ See, Securities Exchange Act Release No. 43833 (January 10, 2001), 66 FR 7822 (January 25, 2001) (SR-ISE-00-10) [sic] at p.7825, note 28 and accompanying text.

¹⁸ *Id.*; See, Securities Exchange Act Release No. 43112 (Aug. 3, 2000), 65 FR 49040 (Aug. 10, 2000) (SR-CBOE-00-28) [sic]; Securities Exchange Act Release No. 43177 (Aug. 18, 2000), 65 FR 51889 (Aug. 25, 2000) (SR-PHLX-00-77) [sic]; Securities Exchange Act Release No. 43228 (Aug. 30, 2000), 65 FR 54330 (Sept. 7, 2000) (SR-AMEX-00-38) [sic]; Securities Exchange Act Release No. 43290 (Sept. 13, 2000), 65 FR 57213 (Sept. 21, 2000) (SR-PCX-00-30) [sic].

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act¹⁹ in general, and furthers the objectives of Section 6(b)(4) of the Act²⁰ in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and other persons using any facility or system which the Exchange operates or controls. The fundamental purpose of the Clearing Submission Fee Credit is to incent the entry of post-trade clearing submissions for non-CHX trades by Institutional Brokers through the Exchange's systems, which generates revenue to the Exchange in the form of Clearing Submission Fees. The Exchange notes that most, if not all, other exchanges issue credits to their members in order to incent them to direct business to their facilities. For example, many exchanges offer a "provide" credit to members which provide liquidity by entering orders on the trading facilities of the exchange with which other orders can interact. Pursuant to Regulation NMS Rule 610 (the "Access Rule"), the maximum rate an exchange can charge to execute against its protected quote is \$0.003 per share for transactions in securities priced over \$1 per share.²¹ In most cases, exchanges offer a provide credit which is less than the maximum charge, although transactions in certain securities, most often Tape B securities, may offer a provide credit which is slightly higher than the maximum rate. The CHX notes that the proposed Clearing Submission Fee Credit is to be set at 8% of the Clearing Submission Fee. That Fee is currently set at the Access Rule maximum rate of \$0.003/share (with a \$100 cap per side) for securities priced over \$1 per share, as specified in the Exchange's Schedule of Fees and

¹⁹ 15 U.S.C. 78f.

²⁰ 15 U.S.C. 78f(b)(4).

²¹ 17 CFR 242.610(c)(1).

Assessment. Thus, even assuming that the Clearing Submission Fee did not reach the \$100 cap, the effective rate of the Clearing Submission Fee Credit is \$0.00024 per share, which is far below the provide credits offered by many other exchanges.²² Based upon these facts, the Exchange believes that the proposed Clearing Submission Fee Credit represents an equitable allocation of reasonable dues, fee, credits and other charges among its members and issuers and other persons using its facilities.

The Exchange further believes that the proposed rule change is consistent with Section 6(b) of the Act²³ in general, and furthers the objectives of Section 6(b)(5) of the Act²⁴ in particular, in that it provides for fees and credits which are not designed to permit unfair discrimination between customers, issuers, brokers or dealers. The Exchange notes that other exchanges have authorized credit payment programs which are available only to certain subcategories of their members. For example, the New York Stock Exchange (“NYSE”) pays a series of credits to its Designated Market Makers (“DMMs”).²⁵ The credits paid to DMMs can exceed the provide credits paid to non-DMMs (which is \$0.0015/share) by a substantial percentage. For example, DMMs can receive a credit of \$0.0035/share (or more than twice as much as paid to ordinary members) when adding liquidity in shares of less active securities under certain specified circumstances.²⁶ The payment by CHX of a much smaller Clearing

²² If the value of the trade was sufficiently large to result in the application of the \$100 maximum fee, the per share amount would necessarily decline.

²³ 15 U.S.C. 78f.

²⁴ 15 U.S.C. 78f(b)(5).

²⁵ See, NYSE Price List 2012, Fees and Credits applicable to Designated Market Makers (“DMMs”), p.4, available on the NYSE’s public website. DMMs (f/k/a specialists) are a subcategory of NYSE members with special rights and obligations, particularly as they relate to the execution of orders on the NYSE’s facilities.

²⁶ Id., p.5.

Submission Fee Credit to its Institutional Brokers would appear to be well within the scope of this precedent. The Exchange also notes that the entry of clearing submissions pursuant to Article 21, Rule 6(a), which gives rise to the Clearing Submission Fee, is limited to Institutional Brokers. Since only Institutional Brokers can engage in the activity which results in Clearing Submission Fees, there would be no purpose served in offering a financial incentive which is based upon the generation of those fees to non-Institutional Brokers. For these reasons, the Exchange believes that the proposed Clearing Submission Fee Credit represents a lawful payment which is distributed in a manner which is reasonable and not unfairly discriminatory.

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. The Exchange believes that payment of a Clearing Submission Fee Credit to the Clearing Broker based on activity handled by it will incent Institutional Brokers to utilize the Exchange's systems and services in forwarding non-CHX trades to NSCC, rather than using alternative mechanisms such as correspondent clearing or Nasdaq's ACT system.

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

The proposed rule change is to take effect pursuant to Section 19(b)(3)(A)(ii) of the Act²⁷ and subparagraph (f)(2) of Rule 19b-4 thereunder²⁸ because it establishes or changes a due, fee

²⁷ 15 U.S.C. 78s(b)(3)(A)(ii).

²⁸ 17 CFR 240.19b-4(f)(2).

or other charge applicable to the Exchange's members and non-members, which renders the proposed rule change effective upon filing.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal 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-2012-05 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 No. SR-CHX-2012-05. 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

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 website viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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-2012-05 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.²⁹

Kevin M. O'Neill
Deputy Secretary

²⁹ 17 CFR 200.30-3(a)(12).