SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68219; File No. SR-CHX-2012-15)

November 13, 2012

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing and Immediate
Effectiveness of Proposed Rule Change to Amend its Order Cancellation Fee

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 November 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, II and III below, which Items

have been prepared by the Exchange. CHX has filed the proposal pursuant to Section

19(b)(3)(A) of the Act[3] 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 the Substance of the Proposed
      Rule Change

The CHX proposes to amend its Schedule of Fees and Assessments (the "Fee Schedule"),

effective November 2, 2012, relating to its order cancellation fee for Participants entering and

subsequently cancelling order under certain circumstances. The text of this proposed rule change

is available on the Exchange's website at http://www.chx.com/rules/proposed_rules.htm and in

the Commission's Public Reference Room, 100 F Street, N.E., Washington, DC 20549.

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[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).

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

History of the CHX Order Cancellation Fee

Beginning in January 2010, the Exchange published Fee Schedule imposed a charge for order cancellations in issues priced $1.00 per share or more[5] submitted by Participants whose orders rarely were at or near the National Best Bid or Offer ("NBBO"), herein referred to as the "original cancellation fee."[6] The application of the original order cancellation fee depended, inter alia, on a calculation involving the number of Wide orders (defined as display-eligible orders in the Matching System which are two (2) or more cents away from the NBBO), Quotable orders (all other display-eligible orders), the number of trades executed and number of cancellations submitted by a Participant in a month.[7] The purpose of the original order cancellation fee was to

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[5]   The Exchange excluded securities priced under $1 per share from being subject to order cancellation fees, as it did not appear that the activity in those issues gave rise to the same concerns as securities priced at or greater than $1 per share. The Exchange continues to find this to be the case and proposes to maintain the exclusion of securities priced under $1 per share from order cancellation fees.

[6]   See Exchange Act Release No. 61392 (Jan. 21, 2010), 75 F.R. 4436 (Jan. 27, 2010) (SR-CHX-2010-02).

[7]   Other requirements included that the trading activity must have occurred in the Regular Trading Session and concerned securities priced $1 per share or more. Also, cancellations

incent Participants to submit orders that were close to the NBBO and to compensate the

Exchange for the systems and operational costs and burdens associated with handling and

recording orders that were rarely executed.

However, soon after the imposition of the original order cancellation fee, the Exchange

had observed that the number of unexecuted and displayed orders had actually increased for

certain Participants. It was apparent to the Exchange that in order to avoid application of the

cancellation fee, certain Participants were submitting Quotable orders to the CHX's Matching

System, but for an extremely short duration, rendering such activity negligible. In addition to

avoiding order cancellation fees, this quotation activity actually exacerbated the operational costs

which the Exchange sought to avoid by creating the order cancellation fee in the first place. The

Exchange had observed that those firms entering the limited durational orders described above

conducted much of their business on our trading facilities in Exchange Traded Funds ("ETFs"),

Exchange Traded Notes ("ETNs") or Exchange Traded Vehicles ("ETVs"), collectively referred

to as Exchange Traded Products ("ETPs").[8] As such, in August 2010, the Exchange amended its

order cancellation fee to exclude all orders, transactions and cancellation activity in ETPs from

the cancellation fee calculation, herein referred to as the "modified order cancellation fee."

Nevertheless, after the modified order cancellation fee went into effect, the Exchange

observed that certain Participants had found a number of methods for avoiding the application of

the modified order cancellation fee. For example, certain Participants submitted Quotable orders

to the CHX's Matching System in non-ETPs, but for an extremely short duration. In other cases,

Participants submitted a large number of Quotable orders in very thinly traded securities prior to

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arising from "Immediate or Cancel" or "Fill or Kill" order types were excluded from the calculation, as well as execution of cross orders.

[8] See Securities Exchange Act Release No. 61392 (January 21, 2010), 75 F.R. 4436 (Jan. 27, 2010) (SR-CHX-2010-02).

the end of the month. These and other similar methods were used by Participants to reduce the order cancellation ratio and therefore, their cancellation fee liability, without a corresponding increase in order executions. As such, in September 2011, the Exchange revamped its order cancellation fee methodology, herein referred to as the "current order cancellation fee."[9]

The current order cancellation fee utilizes a formula, calculated on a daily basis, which divides the Participant's total cancelled volume in a given issue ("cvissue") by the Participant's total executed volume in that issue ("exvissue"). In those instances where a Participant's daily activity in a given issue exceeds a cancellation ratio of 30, the Exchange imposes an order cancellation fee of $.30 on each cancellation in that issue for that day and bills such fees on a monthly basis. By only crediting Participants with Quotable orders of the same issue as Wide orders, the Exchange sought to eliminate the practice of quoting in thinly-traded stocks to reduce cancellation fee liability. Furthermore, by imposing the cancellation fee on a daily basis, the Exchange sought to eliminate end-of-the-month fee avoidance trading activity.

After the current order cancellation fee went into effect, there has been a noticeable reduction in the aforementioned "gaming" of the order cancellation fee formula. However, the Exchange submits that this fee mechanism can be further perfected to promote display liquidity (i.e., the submission of more competitive Quotable orders). As such, further changes to the current order cancellation fee formula are necessary.

Proposed Order Cancellation Fee

The Exchange now proposes to readopt the original order cancellation fee, with amendments to provide for the daily calculation of the order cancellation fee per security and to incorporate new order cancellation formula parameters with values set security-type specific

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[9]   See Securities Exchange Act Release No. 65268 (September 6, 2011), 76 F.R. 56246 (September 12, 2011) (SR-CHX-2011-25).

(i.e., for each <u>derivative and non-derivative</u> tape A, B and C security types). The Exchange

submits that these changes will better incentivize Participants to submit orders near the NBBO

and will allow the Exchange to better combat against "gaming" of the order cancellation fee

formula and to compensate the Exchange for the processing and electronic storage costs

associated with orders which "quote around" the NBBO and rarely execute.

In determining whether the proposed order cancellation fee would be imposed, the

Exchange proposes to utilize a formula that subtracts from the total daily number of Wide or

"W" orders in a given security, the product of Near or "N" orders[10] in the same security

submitted by the Participant in the Regular Trading Session in a given day and its corresponding

N order multiplier or "$N_{mult.}$" The difference between these two values is then divided by "E,"

which is defined as the greater of (a) one (1) or (b) the sum of all Wide and Near orders in a

given security that are submitted and executed (in whole or in part) in the Regular Trading

Session (excluding cross transactions) on a given day.[11] If the remaining value is equal to or

greater than the corresponding "Cancellation Ratio" for that security, a corresponding order

cancellation fee would apply to the Participant for that day's activity in that security. If, however,

the value is less than the corresponding Cancellation Ratio, the Participant would not be assessed

any fee on its cancellation instructions. Although the Cancellation Ratio and order cancellation

fee may vary depending on the type of security, the Exchange proposes to set the Cancellation

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[10]   "Near" is the same as "Quotable," as used in the original and modified order cancellation fee. The Exchange submits that the term "Near" better describes the order as its defining characteristic is that it is near to or better than the NBBO.

[11]   Orders that are less than a round-lot size (less than 100 shares in most securities) and cancellations from "Immediate or Cancel" or "Fill or Kill" orders will not be counted towards the number of cancellations resulting in a fee charged to a Participant. In the event that a Participant has no executed provide orders in a month, we assume that E has a value of one (1) in order to avoid a mathematical error in applying the cancellation fee formula.

Ratio at 150 and the order cancellation fee rate at $0.01 per cancelled order, across the board.[12]

Moreover, the order cancellation fee will be calculated daily, per security and applied per

Account Symbol[13] maintained by each clearing Participant.

In contrast to the original W order, an order may now be considered Wide if any one of

the following three conditions are met.[14] First, a W order is an order priced inferior to the

National Best Bid ("NBB") for a buy order and National Best Offer ("NBO") for a sell order at

the time the order is received by the Matching System and where the difference between the

order price and the NBB or NBO is equal to or greater than its corresponding "Threshold Away

Amount." Second, a W order is an order in a security that is voluntarily cancelled by the

Participant prior to the expiration of its corresponding "Minimum Duration," after acceptance by

the Matching System, without any partial executions. Finally, a W order is one that is marked

"Do Not Display," pursuant to CHX Article 20, Rule 4(b)(9)[15]. By classifying such orders as W

orders, the Exchange endeavors to incentivize Participants to post displayed bids and offers and

thereby promote displayed liquidity on the Exchange. In turn, the Exchange anticipates that

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[12] Changes to any of the proposed parameter values, including Order Cancellation Fee, Cancellation Ratio, Threshold Away Amount, Minimum Duration and N_{mult}, will be made through proposed fee filings pursuant to Rule 19b-4.

[13] Individual Account Symbols are assigned, by the Exchange, to each trading account maintained by a clearing Participant. Each clearing Participant which executes orders on the Exchange has at least one Account Symbol, while some clearing Participants have multiple account symbols. Multiple accounts can be used by clearing Participants, for example, to segregate the order activity of different clients. Calculating and applying the cancellation fee by the Account Symbols maintained by the clearing Participant provides a more precise way of identifying the conduct and correspondent firms implicated by the proposed fee provisions.

[14] As a general matter, all W orders are securities priced at $1.00 share or more when submitted by the Participant in the Regular Trading Session.

[15] Article 20, Rule 4(b)(9) defines a "Do Not Display" order as an order for at least 1,000 shares when entered that is not to be displayed in whole or in part.

increased displayed liquidity would result in a greater number of order executions and, ultimately, increased revenue for the Exchange.

Moreover, the proposed W order introduces two new parameters. First, the "Threshold Away Amount" is a security-type specific value that establishes a bright-line value for determining when an order price is either away or near the NBBO. Although the value of this parameter may eventually vary by security-type, the Exchange proposes to set the Threshold Away Amount at $0.03 for all six security types.[16] Second, the "Minimum Duration" parameter is also a security-type specific value that establishes a bright-line time limit for determining whether an order is considered Wide or may be considered Near. The purpose of this parameter is to promote order execution by curtailing the submission of orders that are not present and displayable for a reasonable period of time and, consequently, to reduce the incidence of disruptive "flickering quotes." The Exchange submits that the longer an order is displayed the better chance it has of being executed. Although this value may also vary by security type, the Exchange proposes to set the Minimum Duration at 10 milliseconds for all six security types.[17]

In contrast to the original "Quotable" or "Q" order, the proposed N order is defined as (1) an order in a security priced at $1.00 per share or more submitted by the Participant in the Regular Trading Session, (2) where the difference between the order price and the NBB or NBO is less than its corresponding Threshold Away Amount and (3) where the order is not voluntarily cancelled by the Participant prior to either its corresponding Minimum Duration or prior to a partial execution of the order, whichever is earlier.

Moreover, the proposed N order will be modified by a "Near order multiplier" or "$N_{mult,}$" which is a security–type specific value, which multiplies the value of N. The practical effect of

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16   <u>Supra</u> note 12.

17   <u>Id</u>.

the N$_{mult}$ is that it enhances the mitigating effect of N orders on the order cancellation ratio. Therefore, the purpose of the N$_{mult}$ is to give the Exchange the ability to enhance or reduce the impact of N on the order cancellation ratio, so as to ensure, <u>inter</u> <u>alia</u>, equitable application of the order cancellation fee. This also provides a strong incentive for Participants to provide more Near orders and fewer Wide orders by giving each Near order two times the weight of a Wide order in calculating the calculation ratio. Although this number may eventually vary by security type, like the Cancellation Ratio, order cancellation fee rate, Threshold Away Amount and Minimum Duration, the Exchange proposes to set the "N$_{mult}$"at two (2) for all six security types.[18] Generally speaking, all of these new parameters will allow the Exchange to better adapt to future issues with the application of the proposed order cancellation formula by merely adjusting these values.

The following examples illustrate how an order may be classified as either Wide or Near. For all Examples, assume submission of a buy order for 1,000 shares of a Tape A non-derivative security:

For Example A, assume that the price of the order is $0.04 inferior to the NBB and it is voluntarily cancelled by the Participant twelve (12) milliseconds after submission to the Matching System. Since the difference between the order price and NBB ("price difference") is greater than the Threshold Away Amount for a Tape A non-derivative security ($0.03), this is a Wide order, notwithstanding all other factors.

For Example B, assume that the price of the order is $0.04 inferior to the NBB and it is fully executed after twelve (12) milliseconds. Since the price difference is greater than the corresponding Threshold Away Amount, this is a Wide order, notwithstanding all other factors.

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[18]   <u>Id</u>.

For Example C, assume that the price of the order is $0.04 inferior to the NBB, there is a partial execution of 500 shares after five (5) milliseconds and the remainder of the order is voluntarily cancelled after twelve (12) milliseconds. Since the price difference is greater than the corresponding Threshold Away Amount, it is a Wide order, notwithstanding all other factors.

For Example D, assume that the price of the order is $0.01 inferior to the NBB, there is a partial execution of 500 shares after five (5) milliseconds, the remainder is voluntarily cancelled after twelve (12) milliseconds and the order is marked "Do Not Display." Since the order is marked "Do Not Display," it is a Wide order, notwithstanding all other factors.

For Example E, assume that the order price is equal to the NBB and the order is fully executed after twelve (12) milliseconds. Since the price difference is less than the corresponding Threshold Away Amount and the order was fully executed, this is a Near order.

For Example F, assume that the order price is equal to the NBB, there is a partial execution of 500 shares after five (5) milliseconds and the balance of the order is voluntarily cancelled after eight (8) milliseconds. Since the price difference is less than the corresponding Threshold Away Amount and the order was cancelled only after a partial execution of 500 shares, this is a Near order, notwithstanding the order having been voluntarily cancelled prior to the expiration of the corresponding Minimum Duration.

For Example G, assume that the order price is $0.01 inferior to the NBB and it is voluntarily cancelled after 20 milliseconds without any executions. Since the price difference is less than the corresponding Threshold Away Amount and the order was only cancelled after the expiration of the corresponding Minimum Duration, it is a Near order.

Moreover, the operation of the proposed order cancellation fee formula can be illustrated by the use of some more examples. For Example 1, assume that on a given day, a Participant

firm submits to the Matching System 200,000 buy orders for a Tape A non-derivative security.

Of this amount, 180,000 orders are priced $0.04 inferior to the NBB and are voluntarily

cancelled after twelve (12) milliseconds, thus making these orders Wide. The remaining 20,000

orders are priced $0.02 inferior to the NBB and are voluntarily cancelled after twelve (12)

milliseconds, thus making these orders Near. Out of 200,000 submitted orders, 1,000 orders are

executed in whole or in part.[19] Pursuant to the proposed formula, the difference between W

(180,000) and the product of N and the corresponding N_{mult} of two (40,000) is 140,000. Dividing

that figure by the number of orders which were executed (E or 1,000) results in a cancellation

ratio of 140. Since the corresponding Cancellation Ratio of a Tape A non-derivative security is

150, no cancellation fee would be assessed on this day, to this Participant, with respect to this

specific security.

Example 1 also illustrates the power of the N_{mult}. Under Example 1, the N_{mult} doubled the

N value to the point that the ratio was brought below the cancellation ratio threshold. That is,

without the N-multiplier, the cancellation ratio would have been 160 and the Participant would

have been assessed the cancellation fee. The utility of the N_{mult} and other parameters lies in its

ability to give the Exchange flexibility to make adjustments when necessary, through proposed

fee filings pursuant to Rule 19b-4, so as to avoid unintended or inequitable application of the

cancellation fee, without having to completely revamp the formula, as well as to promote the

submission of Near orders.

For Example 2, we assume the same facts as above, with the exception that the

Participant firm submits a total of 400,000 buy orders for a Tape A non-derivative security on a

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[19]   Since orders may be partially executed, the Participants may receive more trade
        executions than orders. The Exchange believes that the formula should be based upon the
        number of orders executed and not the number of trades reported.

given day and that 380,000 of those orders are Wide orders. Also assume that 200,000 such W

and N orders are cancelled. Pursuant to the proposed formula, the difference between W

(380,000) and the product of N and the corresponding N multiplier of two (40,000) is 340,000.

Dividing that figure by the number of orders which were executed (E or 1,000) gives us an order

cancellation ratio of 340. Since the corresponding order cancellation ratio of a Tape A non-

derivative security is 150, a cancellation fee of $2,000, which is the product of 200,000

cancellations and $0.01 per order cancelled, would be assessed on this day, to this Participant,

with respect to this specific security.

The purpose of this order cancellation fee is to incent Participants to submit orders which,

when quoted, are at or close to the NBBO or, at the very least, compensate the Exchange for the

processing and electronic storage costs associated with orders which rarely execute. Under the

proposed formula, the likelihood that the cancellation fee would be imposed increases with the

number of Wide orders submitted by the Participant. The formula is designed to isolate a pattern

of behavior in which a Participant submits orders well outside the NBBO and frequently cancels

and reenters such orders to continuously stay outside the NBBO.[20] Participants that submit a

small number of Wide orders or submit a relatively large number of Near orders are unlikely to

be impacted by the proposed fee. Moreover, the Minimum Duration parameter will prevent

Participants from gaming the formula by submitting orders which result in undesirable

"flickering quotes" and the N_{mult} will allow the Exchange to multiply the mitigating effect of

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[20] Although the Exchange is not privy to the trading strategies of the firms submitting large numbers of orders well outside the NBBO, it appears that they are hoping to benefit from Intermarket Sweep Order ("ISO") satisfaction orders sent to the Exchange pursuant to the requirements of Regulation NMS when a trade through occurs on another trading center and the Wide orders are at the CHX BBO. Since the sending of ISO satisfaction orders is not required for non-Regular Trading Session activity, we are excluding such activity from the proposed fee.

Near orders on the order cancellation ratio when necessary. In addition, the likelihood that the cancellation fee will be assessed diminishes as the number of orders actually executed (E) increases. As such, the proposed order cancellation fee will have the dual effect of promoting order execution and compensating the Exchange for the processing and electronic storage costs associated with orders which "quote around" the NBBO and rarely execute.

The Exchange believes that the proposed order cancellation fee benefits the national market system by promoting the display of Near orders, which will result in increased displayed liquidity and reduced order cancellations. This will, in turn, relieve the Exchange's systems capacity and will result in decreased order and market data storage costs. Since Wide orders are infrequently executed, such orders are more expensive, on a relative basis, for the Exchange to receive and process.

The Exchange proposes to implement the cancellation charge effective November 2, 2012. The formula by which the cancellation fee is derived shall be calculated and made available to Participants daily, but billed after the end of the month.

2.   Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act[21] in general, and furthers the objectives of Section 6(b)(4) of the Act[22] 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 Exchange believes that amendments to the order cancellation fee described herein should help to recoup some of the costs of administering and processing large numbers of cancelled orders while fairly allocating costs among Participants according to system use. In

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[21]   15 U.S.C. 78f.

[22]   15 U.S.C. 78f(b)(4).

addition, these changes to the Fee Schedule would equitably allocate reasonable fees among Participants in a non-discriminatory manner by properly imposing fees on those Participants which excessively enter and subsequently cancel orders while not imposing fees on Participants that do not engage in this resource draining behavior. Furthermore, the proposed order cancellation fee of $0.01/order cancellation is reasonable in light of the fact that it is less than the current order cancellation fee of $0.30/order cancellation.

B.   Self-Regulatory Organization's Statement on 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 on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received.

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

The proposed rule change is to take effect pursuant to Section 19(b)(3)(A)(ii) of the Act[23] and subparagraph (f)(2) of Rule 19b-4 thereunder[24] because it establishes or changes a due, fee 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.

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[23]   15 U.S.C. 78s(b)(3)(A)(ii).

[24]   17 CFR 240.19b-4(f)(2).

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. Please include File Number SR-CHX-2012-

  15 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-2012-15. 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 on official business days between the

hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and

copying at the principal offices of 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 Number SR-CHX-2012-15, 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.[25]

Kevin M. O'Neill
Deputy Secretary

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[25] 17 CFR 200.30-3(a)(12).