

Proposed Rule Change by Chicago Stock Exchange
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input checked="" type="checkbox"/>	Amendment <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input checked="" type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
Pilot <input type="checkbox"/>			Rule		
Extension of Time Period for Commission Action <input type="checkbox"/>			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
Date Expires <input type="text"/>			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description
Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
 Title
 E-mail
 Telephone Fax

Signature
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date
 By
 (Name) (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

Form 19b-4 Information**1. Text of Proposed Rule Change**

- (a) The Chicago Stock Exchange, Incorporated (the “CHX” or the “Exchange”), pursuant to Rule 19b-4 of the Securities Exchange Act of 1934 (the “Act” or the “Exchange Act”), proposes to amend its rules to permit Exchange participants to execute orders in subpenny increments. The text of the proposed rule change is set out below:

ARTICLE XX**Regular Trading Sessions**

* * *

Minimum Variations

RULE 22. (a) No change to text.

(b) Orders may be executed on the Exchange in variations smaller than \$.01.

* * *

ARTICLE XXX**Specialists**

* * *

Precedence to Orders in Book

RULE 2. No change to text.

••• Interpretations and Policies:

* * *

.06 Trading [in Nasdaq/NM Securities] in Subpenny Increments

A specialist (including a market maker who holds customer limit orders) shall be deemed to have violated Article XXX, Rule 2 if, while holding a customer limit order (as rounded up to a penny increment) representing the NBBO, the specialist, for his own account, trades with an

incoming market or marketable limit order at a price which is less than \$.01 [one penny] better than such customer limit order in his book. A specialist may, however, buy or sell a security on another market center or exchange at a price less than \$.01 better than a customer limit order on his or her book.

(b) Not applicable.

(c) Not applicable.

2. Procedures of Self-Regulatory Organization

The Exchange's Board of Directors unanimously approved these proposed rule changes on September 15, 2005.

3. Self-Regulatory Organization's Statement on the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Under the Exchange's existing trading rules, the Exchange's participants may not bid or offer in increments below \$.01.¹ Through this filing, the Exchange seeks to confirm that its participants may execute trades in subpenny increments and to establish rules that regulate the instances when its specialists may trade in subpenny increments against incoming orders when there are customer orders in the specialists' books.²

As an initial matter, the proposed rule change would confirm that Exchange participants may execute transactions in subpenny increments.³ As noted above, there is not currently an Exchange rule that prohibits this practice, but the Exchange believes it is appropriate to confirm that trading in subpenny increments is specifically permitted. The Exchange believes that it is appropriate to allow its participants to execute transactions in subpenny 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.⁴

¹ 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.

² The Exchange intends to file a separate proposal to permit its participants and customers, beginning with the implementation date of Rule 612, to bid or offer in subpenny increments in Nasdaq/NM securities, when those bids or offers are less than \$1.00.

³ *See* Article XX, Rule 22(b).

⁴ In addition, although Rule 612 of Regulation NMS, which will be implemented early in 2006, specifically prohibits the display, ranking, or acceptance of bids, offers or orders in subpenny increments where the bid, offer or order is priced at or above \$1.00, it does not prohibit trading in subpenny increments. *See* 17 CFR

Additionally, the proposed rule change would confirm that an Exchange specialist (or a market maker holding customer orders) may not execute an incoming order in a subpenny increment which is less than \$.01 better than a customer limit order in the specialist's (or market maker's) book. This prohibition of "stepping ahead" of a resting customer 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.⁵ The Exchange believes that this rule, which provides protection to customer orders in a specialist's book, should be extended to orders in listed securities before Exchange specialists are specifically permitted to provide subpenny price improvement to inbound orders.

(b) Approval of the rule changes proposed in this submission 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). In particular, the proposed changes are consistent with Section 6(b)(5) of the Act, 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 subpenny increments on the Exchange while providing protection to customer orders that are accepted or displayed in round-lot increments.

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

The Exchange believes that no burden will be placed on competition as a result of the proposed rule changes.

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." See Regulation NMS, Final Rule Release at 37556, Release No. 51808, 70 FR 37496 (July 29, 2005).

⁵ The Exchange's rule relating to subpenny 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); Securities Exchange Act Release No. 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).

5. **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.

6. **Extension of the Time Period for Commission Action**

The Exchange does not consent to an extension of the time period specified in Section 19(b)(2) of the Act.

7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

Not applicable.

8. **Proposed Rule Change Based on Rule of Another Self-Regulatory Organization or of the Commission**

Although this proposal is not specifically based on the rule of another self-regulatory organization, it addresses issues similar those addressed by sections of the National Association of Securities Dealers’ Interpretative Material 2110-2-Trading Ahead of Customer Limit Order (the “Manning Interpretation”).

9. **Exhibits**

Exhibit 1: The Completed Notice of the Proposed Rule Change for publication in the Federal Register.

Exhibits 2-5: Not applicable.

Exhibit 1

SECURITIES AND EXCHANGE COMMISSION

**(Release No. 34-____; File No. SR-CHX-2005-36)
SELF-REGULATORY ORGANIZATIONS**

Proposed Rule Change By The Chicago Stock Exchange, Inc. Regarding Trading in Subpenny Increments

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”), 15 U.S.C. 78s(b)(1), 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 (the “Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the CHX. 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

Through this filing, the Exchange proposes to amend its rules to specifically permit Exchange participants to execute orders in subpenny increments. 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, NE, Washington, DC 20549.

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 Changes

1. Purpose

Under the Exchange's existing trading rules, the Exchange's participants may not bid or offer in increments below \$.01.¹ Through this filing, the Exchange seeks to confirm that its participants may execute trades in subpenny increments and to establish rules that regulate the instances when its specialists may trade in subpenny increments against incoming orders when there are customer orders in the specialists' books.²

As an initial matter, the proposed rule change would confirm that Exchange participants may execute transactions in subpenny increments.³ As noted above, there is not currently an Exchange rule that prohibits this practice, but the Exchange believes it is

¹ 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.

² The Exchange intends to file a separate proposal to permit its participants and customers, beginning with the implementation date of Rule 612, to bid or offer in subpenny increments in Nasdaq/NM securities, when those bids or offers are less than \$1.00.

³ *See* Article XX, Rule 22(b).

appropriate to confirm that trading in subpenny increments is specifically permitted. The Exchange believes that it is appropriate to allow its participants to execute transactions in subpenny 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.⁴

Additionally, the proposed rule change would confirm that an Exchange specialist (or a market maker holding customer orders) may not execute an incoming order in a subpenny increment which is less than \$.01 better than a customer limit order in the specialist's (or market maker's) book. This prohibition of "stepping ahead" of a resting customer 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.⁵ The Exchange believes that this rule, which provides

⁴ In addition, although Rule 612 of Regulation NMS, which will be implemented early in 2006, specifically prohibits the display, ranking, or acceptance of bids, offers or orders in subpenny increments where the bid, offer or order is priced at or above \$1.00, it does not prohibit trading in subpenny 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." *See* Regulation NMS, Final Rule Release at 37556, Release No. 51808, 70 FR 37496 (July 29, 2005).

⁵ The Exchange's pilot rule relating to subpenny 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); Securities Exchange Act Release No. 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

protection to customer orders in a specialist's book, should be extended to orders in listed securities before Exchange specialists are specifically permitted to provide subpenny price improvement to inbound orders.

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).⁶ The Exchange believes that the proposed changes are consistent with Section 6(b)(5) of the Act, 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 subpenny increments on the Exchange while providing protection to customer orders that are accepted or displayed in round-lot increments.

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

The Exchange does not believe that the proposed rule changes 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.

(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).

⁶ 15 U.S.C. 78(f)(b).

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 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 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 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 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, 100 F Street, NE, Washington, DC 20549. 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.⁷

Margaret H. McFarland
Deputy Secretary

⁷ 17 CFR 200.30-3(a)(12).