



April 27, 2005
MR-05-6

**CHICAGO STOCK EXCHANGE, INC.
MARKET REGULATION DEPARTMENT
INFORMATION MEMORANDUM**

Re: Regulation SHO / Short Sale Marking and Tick Test Pilot Program

The Market Regulation Department is communicating the following information to participants related to initiation of the Regulation SHO Pilot Program (exclusion of specific issues from the “tick test” aspect of the SEC’s Short Sale Rule or any SRO short sale price test) on May 2, 2005.

Regulation SHO:

Regulation SHO is a multi-faceted undertaking by the Securities and Exchange Commission (“SEC” or “Commission”) to evaluate and update short sale regulation. Some of the important facets of Regulation SHO include:

- establishing uniform “locate” and “close out” requirements to address problems related to failures to deliver and potentially abusive “naked” short selling
- suspending “tick” test requirements or any other SRO short sale price test for specific issues included in a one-year Pilot Program as of May 2, 2005 to evaluate the effectiveness and necessity of such restrictions
- creating uniform order marking requirements for sales of all securities (“long”, “short” or “short exempt”)

Regulation SHO, Rule 202T – Temporary Rule related to Establishment of a Pilot Program

The SEC’s Short Sale Rule (Exchange Act Rule 10a-1) states that a listed security must be sold short at a plus tick price or at a zero-plus tick with two exceptions (the equalizing exemption (*Exchange Act Rule 10a-1(e)(5)*) and the Madoff exception). Rule 202T is a temporary rule that creates procedures for the Commission to establish a Pilot Program to analyze the necessity and effectiveness of current tick test restrictions. The Pilot Program established will exclude designated securities from the requirements of the tick test (or any other SRO-specific price test) from May 2, 2005 until April 28, 2006.

The Market Regulation Department recommends that participants access the “primary” markets (NYSE, AMEX and Nasdaq) for current lists of Pilot Program issues, since those lists may change over time due to reorganizations, etc.

The SEC has issued a no-action letter to allow brokers and dealers to continue to mark sell orders in Pilot Program issues “short” rather than “short exempt” with no associated penalty as long as they are sending those orders to an exchange or venue that has agreed to “mask” the treatment of these as “short exempt” even if they are marked “short.” The Exchange will be “masking” the treatment of such orders systematically to accommodate this exemption consideration. RFP firms must ensure that their RFP system is set up properly to ensure the “masking” of the issues included in the Pilot Program Category A so they execute customer sell orders in these issues without the current tick test restrictions.

The SEC’s 4/15/05 exemption letter appears on Commission’s website: <http://www.sec.gov/divisions/marketreg/mr-noaction.shtml#sho>.

Mandatory Use of Brokerplex by Floor Brokers to Entry Agency Crossing Transactions

Pursuant to Article XX, Rule 24(a), participants must record all terms of orders originated on the floor. As of April 29, 2005, the Exchange has modified its Brokerplex trade entry functionality to accommodate the entry of a sell short designation in the execution of crossing transactions. Floor brokers must designate the sell side of agency crossing transactions as “short” or “short exempt” as appropriate. Similar modifications to the CSW system are scheduled to be completed in approximately two to three weeks. In the interim, CSW should not be used for the reporting of agency crossing trades impacted by “short” / “short-exempt” marking requirements.

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For further information, you may wish to review the following:

- CHX’s Market Regulation Department Information Memo MR-04-26 (Regulation SHO) dated 12/16/04
- CHX’s Market Regulation Department Information Memo MR-04-27 (Threshold Securities) dated 12/31/04
- SEC’s release “Key Points About Regulation SHO” <http://www.sec.gov/spotlight/keyregshoissues.htm>
- SEC’s release “Regulation SHO – Pilot Program” (in particular Frequently Asked Questions Sections A, B and C) / List of Securities Hyperlink. <http://www.sec.gov/spotlight/shopilot.htm>

Please contact me at (312) 663-2628 or Marguerite Donovan, Director of Surveillance, at (312) 663-2548 with any questions concerning this notice.

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