

through its subsidiary, PCX Equities, Inc. ("PCXE"), filed with the Securities and Exchange Commission ("Commission") a proposed rule change to establish new order types on the Archipelago Exchange ("ArcaEx"), the equity facility of the PCXE, and to amend the ArcaEx Working Order Process to enable the execution of such order types. The PCX filed Amendment No. 1 to the proposal on January 15, 2003.³ The PCX filed Amendment No. 2 on March 7, 2003.⁴ The proposed rule change, as amended by Amendment No. 1, was published for comment and appeared in the **Federal Register** on January 29, 2003.⁵ The Commission received no comment letters in response to the proposed rule change. This order approves the PCX's proposed rule change, as amended, and notices and grants accelerated approval to Amendment No. 2 to the proposed rule change.

II. Description of the Proposal

The proposal would amend PCXE rules to: (1) Adopt several new order types to accommodate the trading of securities listed on the Nasdaq Stock Market, Inc. ("Nasdaq"), on an unlisted trading privileges ("UTP") basis; (2) amend PCXE Rule 7.37 to provide for a limited exemption from the ArcaEx guarantee of executions at the NBBO or

better for certain order types trading Nasdaq securities; (3) reflect the operational requirements of two proposed order types in the Working Order Process; and (4) make various minor technical rule changes to conform to the Nasdaq UTP Plan, which extends UTP to Nasdaq SmallCap securities.

A. Proposed New Order Types

As part of its ongoing preparation for the trading of Nasdaq securities on the ArcaEx pursuant to UTP,⁶ PCX proposes to make several new order types available to Electronic Trading Permit ("ETP") Holders⁷ and Sponsored Participants⁸ (collectively "Users"), which are currently in use on the Archipelago electronic communication network ("ECN").⁹ The proposed new order types are discussed below.

1. Inside Limit Order

An Inside Limit Order is a limit order that is to be executed in whole or in part on ArcaEx. If the order were not executed in its entirety, the remaining portion of the order would be routed pursuant to PCXE Rule 7.37(d) to the market participant¹⁰ with the best displayed price. Any unfilled portion of the order would not be routed to the next best price level until all quotes at the current best bid or offer are exhausted. If the Inside Limit Order were no longer marketable, it would be ranked in the Arca Book pursuant to PCXE Rule 7.36.

2. Discretionary Orders

Currently, a User can submit a Discretionary Order, which is an order to buy or sell a stated amount of a security at a specified, undisplayed price (the "discretionary price"), as well as at a specified, displayed price. The undisplayed prices of a Discretionary Order are represented in the Working

Order Process¹¹ and can be matched with orders on the other side of the market under prescribed conditions. The Exchange proposes to adopt two new variations of the Discretionary Order called a "Passive Discretionary Order" and a "Discretion Limit Order." A summary of these proposed order types is discussed below.

a. *Passive Discretionary.* The Exchange proposes to add PCXE Rule 7.31(h)(2)(A) to define a Passive Discretionary Order. A Discretionary Order may be designated as a Passive Discretionary Order and such order would be routed pursuant to PCXE Rule 7.37(d) only if the displayed price is marketable against an away market participant. If the discretionary price of a Passive Discretionary Order were marketable, such order would only interact with trading interest in the ArcaEx Book pursuant to PCXE Rule 7.37(b)(2) and would not be routed away. Under the proposal, the Passive Discretionary order type will be available for exchange-listed and Nasdaq securities. For Passive Discretionary Orders in exchange-listed securities, if the discretionary price is marketable, such order will only interact with trading interest in the ArcaEx Book pursuant to PCXE Rule 7.37(b)(2) and will not be routed away. A Passive Discretionary Order for ITS Trade-Through Exempt Securities (as defined in PCXE Rule 7.37) will be permitted to trade at a price no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote. For Passive Discretionary Orders in Nasdaq securities, if the discretionary price can be matched against orders in the ArcaEx Book, then such order will interact with trading interest in the ArcaEx Book pursuant to 7.37(b)(2). The NBBO or better execution guarantee set forth in PCXE Rule 7.37 will not apply to Passive Discretionary Orders in Nasdaq securities. Instead, Passive Discretionary Orders in Nasdaq securities would trade at no worse than the ArcaEx BBO.¹²

In the event that a Passive Discretionary Order routed from ArcaEx to another market participant is not executed in its entirety at the other market participant's quote, ArcaEx would attempt to execute the residual trading interest in the ArcaEx Book pursuant to PCXE Rule 7.37. Finally,

³ In Amendment No. 1, the Exchange submitted a new Form 19b-4, which replaced the original filing in its entirety.

⁴ See Letter from Peter Bloom, Acting Managing Director, Regulatory Policy, PCX, to Marc McKayle, Special Counsel, Division of Market Regulation, Commission, dated March 7, 2003 ("Amendment No. 2"). In Amendment No. 2, the Exchange made various clarifying and technical amendments to the proposed rule text to: (1) Reference the "Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges ("Nasdaq Unlisted Trading Privileges Plan") in proposed PCXE Rule 1.1(aa), (2) clarify that the term "OTC/UTP Listing Market" shall have a meaning consistent with the Nasdaq Unlisted Trading Privileges Plan, (3) clarify the definition of "Sweep Reserve Order" by replacing the word "price" with the word "size," (4) clarify the definition of "Random Reserve Order" by indicating that the random reserve value is expressed in round-lot increments and by correcting a grammatical error, (5) amend the definition of "Pegged Order" to reflect that the display price will track the relevant Consolidated Quote information for such orders on a real-time basis and that the displayed price of a Pegged Order designated as a Discretionary Order will track the National Best Bid or Offer ("NBBO"), and that the discretionary price of such order would re-price in correlation to any changes to the displayed price, and (6) clarify that Immediate or Cancel ("IOC"), NOW, Post No Preference ("PNP"), Passive Discretionary, Discretion Limit, IOC Cross and PNP Cross orders in Nasdaq securities would receive executions no worse than the ArcaEx Best Bid or Offer ("BBO").

⁵ Securities Exchange Act Release No. 47223 (January 21, 2003), 68 FR 4527 (January 29, 2003) (SR-PCX-2002-75).

⁶ The Nasdaq UTP Plan was initially approved in 1990. See Securities Exchange Act Release No. 28146 (June 26, 1990), 55 FR 27919 (July 6, 1990) (S7-24-89). It has subsequently been amended on several occasions to, among other things, admit new Participants. See also Securities Exchange Act Release No. 46381 (August 19, 2002), 67 FR 54687 (August 23, 2002) (S7-24-89) (Order approving most recent amendments to Nasdaq UTP Plan, the 13th Amendment).

⁷ See PCXE Rule 1.1(n).

⁸ A "Sponsored Participant" means "a person which has entered into a sponsorship arrangement with a Sponsoring ETP Holder pursuant to [PCXE] Rule 7.29." See PCXE Rule 1.1(tt).

⁹ The broker-dealer commonly referred to as the Archipelago ECN is Archipelago Securities, a wholly owned subsidiary of Archipelago Holdings LLC and a member of the NASD. The ECN function will cease to operate as such once all the Nasdaq securities have been transferred to ArcaEx.

¹⁰ See PCXE Rule 1.1(w) (definition of "market participant").

¹¹ The Working Order Process is the third step in the ArcaEx execution algorithm. Working Orders are defined to include any order with a conditional or undisplayed price and/or size, including All-or-None, Discretionary, and Reserve Orders. See PCXE Rule 7.37(b)(2) (description of "Working Order Process").

¹² See Amendment No. 2, *supra* note 4.