

Passive Discretionary Orders that are not marketable would be ranked in the ArcaEx Book pursuant to PCXE Rule 7.36.

b. Discretion Limit. The Exchange also proposes to add PCXE Rule 7.31(h)(2)(B) to define a Discretion Limit Order. A Discretionary Order may be designated as a Discretion Limit Order for Nasdaq securities only. If the discretionary price of a Discretion Limit Order could be matched against trading interest in the ArcaEx Book, then such order would be executed at the discretionary price or better against the displayed share size of available trading interest in the ArcaEx Book, regardless of size. If the discretionary price of a Discretion Limit Order could be matched against an away market participant, then such order would be routed pursuant to PCXE Rule 7.37(d) but only if the displayed share size of the Discretion Limit Order is equal to or less than the displayed share size of the away market participant. The NBBO or better execution guarantee set forth in PCXE Rule 7.37 would not apply to Discretion Limit Orders. Instead, Discretion Limit Orders, which will only be available for the trading of Nasdaq Securities, will not trade at a price inferior to the ArcaEx BBO.¹³

3. Reserve Orders

Under current PCXE Rule 7.31(h)(3), a Reserve Order is a limit order with a portion of the size displayed and with a reserve portion of the size ("reserve size") that is not displayed on the ArcaEx Book. With this filing, the Exchange proposes to adopt two new variations of the Reserve Order, a "Sweep Reserve Order" and a "Random Reserve Order." These proposed order types would be ranked and maintained in the Display Order Process¹⁴ and/or Working Order Process of the ArcaEx Book according to price-time priority and would be processed for internal matches in the same manner as standard Reserve Orders pursuant to PCXE Rule 7.37(b)(2). The proposed rule change regarding Sweep Reserve Orders should clarify how ArcaEx treats such orders when routing to other market participants is required. In the case of a Random Reserve Order, the proposed rule change would allow a User to define the original display quantity and a random reserve value in a share

amount that would be used to determine the displayed quantity within a defined range each time it is replenished. These proposed order types are discussed separately below.

a. Sweep Reserve Order. Under proposed PCXE Rule 7.31(h)(3)(A), a Reserve Order may be designated as a Sweep Reserve Order. Based upon a User's instruction, if the displayed price of a Sweep Reserve Order is marketable against an away market participant(s), then such order will be routed (i) serially as component orders, such that each component corresponds to the displayed size, or (ii) only once in its entirety, including both the displayed and reserve portions. The Exchange believes that this rule change codifies current order routing methodology, and believes that the proposed Sweep Reserve Order type is clearly implied in current PCXE Rule 7.37(d)(2)(A)(ii).

b. Random Reserve Order. The Exchange proposes to add PCXE Rule 7.31(h)(3)(B) to define a Random Reserve Order. Under the rule proposal, a User could determine a display and reserve quantity for a Reserve Order. In addition, a User could also define a random reserve delta (expressed in a share amount) to determine the number of shares to display when the quote is refreshed from reserve.¹⁵ Users are required to display at least 100 shares for all Reserve Orders including Random Reserve Orders. If the User does not specify the random reserve delta or the random reserve delta is set to zero, the ArcaEx system would assign the displayed size of the Reserve Order to vary to within 20% of the original specified displayed size. Should a User enter a Random Reserve Order with a display amount of 500 shares or less and a random reserve delta that is unspecified or set to zero, the order would be handled as a regular Reserve Order. The ArcaEx system would refresh the display quantity to the original displayed size, and would not vary the display quantity.

4. Pegged Orders

The Exchange proposes to modify the ArcaEx trading system to accept Pegged Orders. A Pegged Order is a limit order to buy or sell a stated amount of a security at a display price set to track the current bid or ask of the NBBO in an amount specified by the User.¹⁶ The tracking of the relevant Consolidated Quote information for Pegged Orders would occur dynamically on a real-time basis. The associated price of each

Pegged Order that is updated would be assigned a new entry time with priority in accordance with PCXE Rule 7.36(a). A Pegged Order may be designated as a Reserve Order or Discretionary Order and would be subject to the applicable order execution rules. The displayed price of a Pegged Order designated as a Discretionary Order would track the NBBO, and discretionary price of such order would re-price in correlation to any changes to the displayed price.¹⁷ Finally, Pegged Orders are only eligible during the Core Session.

B. Changes to PCXE Rule 7.37

The Exchange's current rules governing the order execution processes for orders in the ArcaEx Book are set forth in PCXE Rule 7.37. Presently, PCXE Rule 7.37 provides, in part, that for an execution to occur in any Order Process, the price must be equal to or better than the NBBO. The requirements of this rule do not apply to orders designated as IOC, NOW and PNP in certain exchange-traded funds ("ETFs") that are subject to the Commission's order granting a *de minimis* exemption from the trade-through restrictions of the Intermarket Trading System ("ITS") Plan; provided, however, that any resulting executions will be at a price no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote.¹⁸ The Exchange proposes that the requirements of PCXE Rule 7.37 would not apply to existing order types (IOC, NOW and PNP orders) and proposed new order types (Passive Discretionary, Discretion Limit, IOC Cross and PNP Cross)¹⁹ in Nasdaq securities, provided however that such orders in Nasdaq securities would not result in an execution at a price less than the ArcaEx BBO.²⁰

C. Working Order Process

The Exchange proposes the following conforming changes to certain provisions of the Working Order Process set forth in PCXE Rule 7.37(b)(2):

Under the proposal PCXE Rule 7.37(b)(2) will be amended to clarify the

¹³ See Amendment No. 2, *supra* note 4.

¹⁸ See Securities Exchange Act Release No. 46428 (August 28, 2002), 67 FR 56607 (September 4, 2002) (Order Pursuant to Section 11A of the Act and Rule 11Aa3-2(f) thereunder Granting a De Minimis Exemption for Transactions in Certain ETFs from the ITS Trade-Through Provisions. See also Securities Exchange Act Release No. 46684 (October 17, 2002), 67 FR 65618 (October 25, 2002) (SR-PCX-2002-69).

¹⁹ See Securities Exchange Act Release No. 47178 (January 13, 2003), 68 FR 3076 (January 22, 2003) (Order approving File No. SR-PCX-2002-74). The Commission recently approved a separate proposed rule change establishing IOC Cross and PNP Cross Orders.

²⁰ See Amendment No. 2, *supra* note 4.

¹³ See Amendment No. 2, *supra* note 4.

¹⁴ The Display Order Process is the second step in the ArcaEx execution algorithm. In this process, the ArcaEx system matches an incoming marketable order against orders in the Display Order Process at the display price of the resident order for the total size available at the that price or for the size of the incoming order. See PCXE Rule 7.37(b)(1) description of "Display Order Process".

¹⁵ See Amendment No. 2, *supra* note 4.

¹⁶ See proposed PCXE Rule 7.31(cc) (definition of "Pegged Order").