

ArcaEx Book. For example, a User could submit a Reserve Order to buy 5000 shares of XYZ security at 20 with a request that 1000 shares are displayed and 4000 shares, as the reserve size, are not displayed. With this filing, the Exchange is proposing to adopt two new variations of the Reserve Order called a "Sweep Reserve Order" and a "Random Reserve Order." These proposed order types would be ranked and maintained in the Display Order Process<sup>12</sup> and/or Working Order Process of the ArcaEx Book according to price-time priority and would be processed for internal matches in a manner no different than a standard Reserve Order pursuant to PCXE rule 7.37(b)(2). The proposed rule change regarding Sweep Reserve Orders merely provides a clarification as to the manner in which such orders would be treated through ArcaEx's trading system when the routing of these orders 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 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.

i. *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 price, 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 that the proposed Sweep Reserve Order type is clearly implied in current PCXE rule 7.37(d)(2)(A)(ii).

ii. *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 define not only a display and reserve quantity, but also a random reserve delta that could be used to determine the displayed quantity within a defined range each time it is

replenished in a random amount (rounded to the nearest round lot). Users are required to display at least 100 shares for all Reserve Orders including Random Reserve Orders. The following examples illustrate the use of the Random Reserve Order.

Suppose a User entered a Random Reserve Order for 10,000 shares with a display quantity of 2000 shares and a random reserve delta of 200 shares. This order would randomly display orders at 1800 (200 shares less than the original display quantity), 1900 (100 shares less than the original display quantity), 2000, 2100 (100 shares more than the original display quantity) or 2200 shares (200 shares more than the original display quantity) each time the displayed portion of the order is replenished. 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. In the example above, the displayed amount would fall within a 400-share range (*i.e.*, 20% of 2000 shares is 400 shares).

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. Suppose a User entered a Random Reserve Order with a display amount of 100 shares, a reserve amount of 1,000 shares, and a random reserve of zero. The ArcaEx system would treat this order as a regular Reserve Order and the display quantity will be refreshed at the original displayed size (100 shares), *i.e.*, the ArcaEx system would not vary the display quantity for this order.

d. *Pegged Orders*

The Exchange is proposing 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.<sup>13</sup> The tracking of the relevant Consolidated Quote information for Pegged Orders would occur on a real-time basis in a dynamic fashion. The associated price of each Pegged Order that is updated would be assigned a new entry time with priority in accordance with 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. Finally, Pegged Orders are only eligible during the Core Session.

2. *Amendment 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, 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 Immediate-or-Cancel ("IOC"), NOW and Post No Preference ("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.<sup>14</sup> The current proposal would also broaden this exception to include Passive Discretionary, IOC Cross and PNP Cross order types.<sup>15</sup> The definition for a Passive Discretionary Order includes a provision clarifying the application of the Commission's *de minimis* exemption order. The Exchange is also proposing that the aforementioned NBBO price protection restriction would not apply to certain existing order types (IOC, NOW and PNP orders) and proposed new order types (Passive Discretionary, Discretion Limit, IOC Cross and PNP Cross)<sup>16</sup> in Nasdaq securities. The definition for IOC, NOW, PNP, Passive Discretionary and Discretion Limit order types<sup>17</sup> includes a provision clarifying that the NBBO price protection requirement set forth in rule 7.37 will not apply to these order types in Nasdaq securities. Unlike the market for listed securities, there is no linkage between participants in the Nasdaq UTP Plan and, therefore, no rules that prohibit a participant from trading through another participant's quote.<sup>18</sup> Consequently, the Exchange believes that it would not be practicable to attempt to provide such orders with intermarket price protection. The

<sup>14</sup> 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).

<sup>15</sup> The Exchange notes that it has filed a separate proposed rule change relating to IOC Cross and PNP Cross Orders. See Securities Exchange Act Release No. 47010 (December 16, 2002), 67 FR 78554 (December 24, 2002) (SR-PCX-2002-74).

<sup>16</sup> *Id.*

<sup>17</sup> See generally PCXE rule 7.31.

<sup>18</sup> See note 1, *supra*.

<sup>12</sup> 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) (description of "Display Order Process").

<sup>13</sup> See proposed PCXE rule 7.31(cc) (definition of "Pegged Order").