I. Introduction

On April 15, 2005, the Pacific Exchange, Inc. (n/k/a NYSE Arca, Inc.) (“NYSE Arca” or “Exchange”), through its wholly-owned subsidiary PCX Equities, Inc. (n/k/a “NYSE Arca Equities, Inc.”), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) and Rule 19b-4 thereunder, a proposed rule change to create a new order type, the Passive Liquidity Order (“PL Order”), for use on NYSE Arca, LLC (f/k/a the Archipelago Exchange) (“NYSE Arca Marketplace”). The Exchange filed Amendment No. 1 to the proposed rule change on June 3, 2005. The Exchange filed Amendment No. 2 to the proposed rule change on August 26, 2005. The proposed rule change, as amended, was published for comment in the Federal Register on September 21, 2005. The Commission received 2 comments from the public in response to the proposed rule change.

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3 Amendment No. 1, which replaced the original filing, made technical and clarifying changes to the proposed rule change.
4 Amendment No. 2, which replaced Amendment No. 1, clarified the execution priority of Passive Liquidity Orders in NYSE Arca Equities Rule 7.37, as compared to other orders that are part of the Display Order Process and the Working Order Processes, and as compared to Directed Fills in the Display Order Process. In addition, Amendment No. 2 made other technical and clarifying changes to the proposed rule change.
change.\textsuperscript{6} The Exchange filed Amendment No. 3 to the proposed rule change on December 1, 2005.\textsuperscript{7} The Exchange filed Amendment No. 4 to the proposed rule change on August 28, 2006.\textsuperscript{8} This order approves the proposed rule, as amended by Amendment Nos. 1 and 2; grants accelerated approval to Amendment Nos. 3 and 4; and solicits comments from interested persons on Amendment Nos. 3 and 4.

II. **Description**

The Exchange, through its wholly-owned subsidiary NYSE Arca Equities, proposes to establish a new order type, the PL Order. The PL Order would be an order to buy or sell a stated number of shares of a security at a specified, undisplayed price.

Under the proposal, PL Orders would be entered with a size of at least 200 shares and would only be permitted in round lot denominations. PL Orders would not route out of NYSE Arca Marketplace to other Market Centers\textsuperscript{9} and would not execute against incoming orders sent from other markets.

The NYSE Arca Marketplace ranks and maintains limit orders in the NYSE Arca Marketplace Order Book (“NYSE Arca Book”) according to price/time priority and generally

\textsuperscript{6} See letter from George U. Sauter, Managing Director, the Vanguard Group, Inc., to Jonathan G. Katz, Secretary, Commission, dated October 12, 2005 (“Vanguard Letter”). See also letter from Neal L. Wolkoff, Chairman and CEO, American Stock Exchange LLC, to Jonathan G. Katz, Secretary, Commission, dated June 28, 2005 (“Amex Letter”).

\textsuperscript{7} Amendment No. 3 proposed that in securities where the NYSE Arca Marketplace is the primary listings market and there is a Lead Market Maker (“LMM”), the PL Order would be limited to the LMM registered in the primary listing. In exchange for this exclusive use, LMMs would be subject to performance standards, as defined by the Exchange. In Amendment No. 3, the Exchange also addressed comments made in the Vanguard Letter.

\textsuperscript{8} Amendment No. 4 proposed that LMMs who are registered in the primary listing of an issue on the NYSE Arca Marketplace may execute PL Orders only if such LMMs comply with certain quotation requirements.

\textsuperscript{9} 17 CFR 242.600(b)(38).
affords priority to displayed orders in the Display Order Process and prices over undisplayed
orders in the Working Order Process, sizes and prices. However, PL Orders with a price
superior to that of displayed orders would have price priority and would execute ahead of
inferior priced displayed orders in the Display Order Process. A PL Order would be executed in
the Working Order Process after all other orders, including Reserve Orders and the display
portion of Discretionary Orders at a particular price level, but would have priority over
 undisplayed Discretionary Order interest. In addition, PL Orders with a price superior to that of
Directed Fills would have price priority and would execute ahead of inferior priced Directed
Fills in the Directed Order Process.

In Amendment No. 3, the Exchange proposed that in securities where the Exchange is the
primary listings market for which an LMM has been registered, the PL Order would be available
only to the LMM registered in the primary listing. As part of its rationale for allowing this
exclusive listing, the Exchange stated that such exclusive use of the PL Order by LMMs for
primary listings is consistent with allowing the LMM the exclusive use of the Directed Process
in primary listings. In LMMs must adhere to the quote spread and size levels set by the Exchange
in order to be registered as LMMs on the Exchange. In all other equity and ETF issues traded on
the Exchange, whether dually listed issues or issues traded pursuant to unlisted trading
privileges, the PL Order would remain available to all Users.

(December 1, 2005) (approving the Exchange’s new Directed Order Process which
introduced the classification of LMMs on the Exchange and defined a LMM as “a
registered Market Maker that is the exclusive Designated Market Maker in listings for
which the [Exchange] is the primary market”). The difference between the Directed
Order Process and PL Orders is that the possible price improvement offered by a PL
Order would be available to incoming marketable orders submitted by any User, and not
just those orders from specified Users as determined by the LMM.
In Amendment No. 4, the Exchange proposed that Lead Market Makers (“LMMs”) who are registered in the primary listing of an issue on the NYSE Arca Marketplace would have exclusive access to PL Orders only if such LMMs comply with certain requirements. Specifically, in such instance, the Exchange proposes that a buy (sell) PL Order will only execute against an incoming sell (buy) marketable order only if one of the following conditions is met: (1) the NYSE Arca Book is at the national best bid (offer) (“NBBO”) and the LMM has a displayed bid (offer) equal to the NYSE Arca Marketplace best bid (offer) (“BBO”) with a quoted size at least as large as the total size of the incoming marketable sell (buy) order against which the PL Order would trade; (2) the NYSE Arca Book is at the NBBO and the LMM has a displayed bid (offer) $0.01 below (above) the NYSE Arca Marketplace BBO with a quoted size at least twice as large as the total size of the incoming marketable sell (buy) order against which the PL Order would trade; or (3) where the NYSE Arca Book is not at the NBBO and the price of the PL Order is at least $0.01 higher (lower) than the NYSE Arca Book BBO and the incoming marketable order is not designated as an “inter-market sweep” order as defined in Regulation NMS. The Exchange also clarified that a PL Order would not execute if it is priced inferior to the other orders in the NYSE Arca Book or if the LMM does not have a displayed order within $0.01 of the BBO when NYSE Arca is at the NBBO.

III. Comments Received

As stated above, the Commission received two comment letters on this proposal. One commenter requested that the Commission abstain from granting accelerated approval because the proposed order type raises issues about market structure that should be vetted publicly.

11 17 CFR 242.600(b)(30).
12 See Amex Letter and Vanguard Letter, supra note 6.
Another commenter stated that undisplayed orders, including the proposed PL Order, create a disincentive to displaying limit orders, which the commenter believes is not in the best interest of an efficient market structure.\textsuperscript{14} To the extent Market Centers offer such order types, however, the commenter agrees that they should be available to all users.\textsuperscript{15}

In its response to the Vanguard Letter,\textsuperscript{16} the Exchange stated that the introduction of the PL Order would attract liquidity to the Exchange and that with this additional order type, investors can express their trading interest more accurately than is possible with other order types. In addition, as discussed above, the Exchange believes that restricting the use of the PL Order to LMMs is consistent with the Exchange’s rule limiting the Directed Order Process to LMMs in primary listings and is justified by the fact that LMMs would be subject to performance standards relating to quote spread and size levels set by the Exchange and would have to comply with certain display requirements.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 3 and 4, including whether Amendment Nos. 3 and 4 are 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 Number SR-PCX-2005-53 on the subject line.

\textsuperscript{13} See Amex Letter, supra note 6.
\textsuperscript{14} See Vanguard Letter, supra note 6, at 1.
\textsuperscript{15} See Vanguard Letter, supra note 6, at 3.
\textsuperscript{16} See Amendment No. 3, supra note 7.
Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to Amendment Nos. 3 and 4 to File Number SR-PCX-2005-53. 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 change 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 Section, Station Place, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NYSE Arca. 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 Amendment Nos. 3 and 4 to File Number SR-PCX-2005-53 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder
applicable to a national securities exchange.\textsuperscript{17} In particular, the Commission finds that the proposal, as amended, is consistent with the provisions of Section 6(b)(5) of the Act,\textsuperscript{18} which requires, among other things, that a national securities exchange’s rules be designed to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism of a free and open market and a national market system and; in general, to protect investors and the public interest.

This proposal would create a new order type, the PL Order. The Commission believes that the proposal is reasonably designed to permit passive interaction with incoming orders while protecting displayed orders in the NYSE Arca Book that are priced at or better than the PL Order. In the Vanguard Letter, the commenter was concerned that the proposed PL Order would create a disincentive to displaying limit orders. The Commission emphasizes the fact that a PL Order would never execute ahead of a displayed order that is at the same or a better price. As noted above, PL Orders would be executed in the Working Order Process\textsuperscript{19} after all other orders, including reserve orders and the display portion of discretionary orders at a particular price level.\textsuperscript{20}

The Commission believes that the ability of LMMs appointed in primary listings on the Exchange to use the PL Order exclusively is consistent with the requirements of the Act. The Commission notes that NYSE specialists similarly have exclusive ability to provide price improvement to incoming orders on its Hybrid system only if the specialists are meaningfully

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\textsuperscript{17} In approving this proposal, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).
\textsuperscript{18} 15 U.S.C. 78f(b)(5).
\textsuperscript{19} See NYSE Arca Rule 7.37(b)(2).
\textsuperscript{20} As also noted above, PL Orders would, however, take precedence over undisplayed discretionary order interest.
\end{flushleft}
represented in the BBO and provide a minimum amount of price improvement.\footnote{21} LMMs appointed in primary listings would be able to use the PL Order only if (1) the NYSE Arca Book is at the NBBO, the order is priced better than the Exchange's BBO by the Minimum Price Variation (“MPV”), and the LMM is quoting a certain minimum amount in proximity to the Exchange's BBO\footnote{22} or (2) the NYSE Arca Book is not at the NBBO, the order is priced better than the Exchange's BBO by the MPV, and the incoming order is not designated an inter-market sweep order.\footnote{23} The Commission believes that permitting Users of the PL Order to provide price improvement by at least the MPV could increase the quality of NYSE Arca's market, and that the condition that LMMs must quote a minimum amount in proximity to the Exchange's BBO might enhance depth and liquidity at or near the Exchange's BBO.

VI. Accelerated Approval of Amendment Nos. 3 and 4

The Commission finds good cause for approving Amendment Nos. 3 and 4 to the proposed rule change prior to the thirtieth day after the amendment is published for comment in the Federal Register pursuant to Section 19(b)(2) of the Act.\footnote{24} In Amendment No. 3, the Exchange proposed that in issues where NYSE Arca Marketplace is the primary listing market and there is an LMM, the PL Order would be available only to the LMM registered in the primary listing. The Exchange also proposed that LMMs would be held to certain performance

\footnote{21}{See NYSE Rule 104.} \footnote{22}{If the NYSE Arca Book is at the NBBO, the LMM must have a displayed bid (offer) that is either equal to the NYSE Arca Marketplace BBO with a quoted size at least as large as the total size of the incoming marketable sell (buy) order against which the PL Order would trade or $0.01 below (above) the NYSE Arca Marketplace BBO with a quoted size at least twice as large as the total size of the incoming marketable sell (buy) order against which the PL Order would trade.} \footnote{23}{See 17 CFR 242.600(b)(30).} \footnote{24}{15 U.S.C. 78s(b)(2).}
obligations related to quote size and quote spread. In Amendment No. 4, the Exchange proposed that LMMs who are registered in the primary listing of an issue on the NYSE Arca Marketplace will have exclusive access to PL Orders only if such LMMs comply with certain quoting and price improvement requirements.

The Commission believes that limiting use of the PL Order to LMMs registered in a primary listing raises no novel issue of regulatory concern because, as noted above, the Commission recently approved a similar functionality for New York Stock Exchange “NYSE” specialists.25 Under NYSE Hybrid Rules, NYSE specialists may employ algorithms which generate trading messages that provide price improvement to incoming orders only if the specialist is represented in a meaningful amount in the NYSE’s BBO.26 Accordingly, the Commission finds good cause to accelerate approval of Amendment Nos. 3 and 4.


26 See NYSE Rule 104.
VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,\(^{27}\) that the proposed rule change (SR-PCX-2005-53), as amended by Amendment Nos. 1 and 2, be, and it hereby is, approved, and that Amendment Nos. 3 and 4 are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.\(^{28}\)

Nancy M. Morris
Secretary


\(^{28}\) 17 CFR 200.30-3(a)(12).