

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58681; File No. SR-NYSEArca-2008-90)

September 29, 2008

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Amending NYSE Arca Equities Rule 7.31(x) to Change the Permissible Order Entry Time and Eligibility of its Primary Only Order and Amending NYSE Arca Equities Rule 14.3 to Establish Procedures Designed to Manage Potential Informational Advantages Resulting from the Affiliation between the Exchange and Archipelago Securities L.L.C.

I. Introduction

On August 20, 2008, NYSE Arca, Inc., (“NYSE Arca” or “Exchange”), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to (i) amend NYSE Arca Equities Rule 7.31(x) to change the permissible order entry time and eligibility of its Primary Only Order type (“PO Order”) and (ii) amend NYSE Arca Equities Rule 14.3 to establish procedures designed to manage potential information advantages resulting from the affiliation between the Exchange and Archipelago Securities L.L.C. (“Arca Securities”). On September 4, 2008, the proposed rule change was published for comment in the Federal Register.<sup>3</sup> The Commission received no comments on the proposed rule change. On

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 58431 (August 27, 2008), 73 FR 51681 (“PO Plus Notice”).

On February 13, 2008, NYSE Arca filed a proposal to modify its PO Order pursuant to 19(b)(3)(A), making it effective upon filing with the Commission. See Securities Exchange Act Release No. 57377 (February 25, 2008), 73 FR 11177 (February 29, 2008) (SR-NYSEArca-2008-19). The Commission abrogated the proposal on April 11, 2008, noting that it has, in the past, expressed concern about the potential for unfair competition and conflicts of interest between an exchange’s self-regulatory obligations and its commercial interests if an exchange were affiliated with one of its members, as well as the potential for unfair competitive advantage that the affiliated member could have by

September 25, 2008, NYSE Arca filed Amendment No. 1.<sup>4</sup> This order approves the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

## II. Background

### A. PO Plus Proposal

NYSE Arca proposes to expand the availability of its PO Order type. NYSE Arca's PO Order is a market or limit order that is to be routed to the primary market in that security without first attempting to access liquidity on the NYSE Arca book. Such orders, currently, may only be entered until a cut-off time established from time to time by the Exchange.<sup>5</sup> The orders are routed to the primary market through NYSE Arca's routing broker-dealer, Arca Securities, which is an affiliate of NYSE Arca as described more fully below. The "primary market" may be the New York Stock Exchange LLC ("NYSE") or the American Stock Exchange LLC ("Amex"),<sup>6</sup>

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virtues of informational or operational advantages, or the ability to receive preferential treatment. See Securities Exchange Act Release No. 57648 (April 11, 2008), 73 FR 20981 (April 17, 2008) at note 9 and accompanying text. The Commission noted that NYSE Arca's filing raised this issue by expanding the activities of Arca Securities in sending orders to its affiliate, the NYSE, and therefore should be subject to notice and comment and review pursuant to Sections 19(b)(1) and 19(b)(2) of the Act. See id. at note 10 and accompanying text. Further, the Commission stated that the issue of whether the routing of PO Orders by Arca Securities to the NYSE is consistent with existing NYSE and NYSE Arca rules should be subject to notice and comment and review pursuant to Sections 19(b)(1) and 19(b)(2) of the Act. See id. at note 11 and accompanying text.

<sup>4</sup> In Amendment No. 1, NYSE Arca requested that the Commission accelerate approval of the proposed rule change. Because Amendment No. 1 is technical in nature, the Commission is not publishing it for comment.

<sup>5</sup> See NYSE Arca Equities Rule 7.31(x). Currently, a PO Order entered for participation in the primary market opening must be entered before 6:28 a.m. (Pacific Time), and a PO Order entered for participation in the primary market re-opening after a trading halt must be entered after trading was halted on NYSE Arca and before the re-opening time. See id.

(“Amex”),<sup>6</sup> each of which, as described more fully below, also is (or will be) an affiliate of NYSE Arca and Arca Securities.

NYSE Arca proposes to modify the PO Order type so that such orders may be entered at any time throughout the trading day and be immediately routed to the primary, listing market for execution. A PO Order would have to be a day or immediate-or-cancel (“IOC”) order. If the PO Order is not an IOC order it would remain at the venue to which it was routed, until executed, cancelled, or the end of day. Further, under the proposal, PO Orders entered for participation in the primary market, other than for participation in the primary market opening or primary market re-opening, must be marked with the modifier PO+. Such orders would be eligible for entry and execution throughout the trading day. Finally, the proposal permits an entering party to designate a PO Order as an Intermarket Sweep Order (as defined in Rule 600(b) of Regulation NMS under the Act).<sup>7</sup>

In addition, NYSE Arca proposes that: (1) the use of certain non-public information by Arca Securities would be restricted; (2) NYSE Regulation, Inc. (“NYSE Regulation”) would collect and maintain certain information with respect to Arca Securities; and (3) routing by Arca Securities to NYSE Arca, in Arca Securities’s capacity as a facility of NYSE, be authorized for a pilot period of 12 months.

#### B. Arca Securities Routing Function

NYSE Euronext, a Delaware Corporation (“NYSE Euronext”) currently indirectly owns

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<sup>6</sup> Amex will change its name to NYSE Alternext US LLC in connection with the acquisition of Amex by NYSE Euronext. See Securities Exchange Act Release No. 58673, (September 29, 2008) (SR-Amex-2008-62; SR-NYSE-2008-60) (order approving a proposed rule change related to the acquisition of the Amex by NYSE Euronext) (“NYSE Alternext US Order”). The transaction is expected to close shortly.

<sup>7</sup> 17 CFR 240.600(b).

Arca Securities, a broker-dealer, that is a member of NYSE Arca. In addition, NYSE Euronext indirectly owns two registered securities exchanges -- NYSE Arca and NYSE -- and has entered into an agreement to acquire a third securities exchange -- Amex.<sup>8</sup> Thus, Arca Securities is (or will be) an affiliate of each of these exchanges.

NYSE Arca Equities Rule 3.10 prohibits: (1) an NYSE Arca member from being affiliated with NYSE Group, Inc. (“NYSE Group”);<sup>9</sup> and (2) NYSE Group, or any entity with which it is affiliated, from maintaining an ownership interest in a member. Thus, Arca Securities’s affiliation with NYSE Arca would violate NYSE Arca rules, absent Commission approval.

The Commission has approved Arca Securities affiliation with, and operation as a facility of, NYSE Arca for the provision of outbound routing from NYSE Arca to other market centers,<sup>10</sup> subject to certain conditions.<sup>11</sup> Arca Securities’s operation as a facility providing outbound routing for NYSE Arca was (and continues to be) subject to the conditions that: (1) Arca Securities continue to operate and be regulated as a facility of NYSE Arca; (2) Arca Securities only provide outbound routing services; (3) the primary regulatory responsibility for Arca Securities would lie with an unaffiliated SRO; and (4) the use of Arca Securities for outbound routing is available only to NYSE Arca members and use of Arca Securities’s routing function

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<sup>8</sup> See NYSE Alternext US Order, supra note 6.

<sup>9</sup> NYSE is wholly owned by NYSE Group, which is in turn wholly owned by NYSE Euronext.

<sup>10</sup> Such outbound routing includes the routing of PO Orders to the primary market.

<sup>11</sup> See Securities Exchange Act Release No. 52497 (September 22, 2005), 70 FR 56949 (September 29, 2005) (SR-PCX-2005-90) (order approving proposed rule changes in connection with the acquisition of the Pacific Exchange, Inc. (“PCX,” n/k/a NYSE Arca) by Archipelago Holdings, Inc.).

remains optional.<sup>12</sup> Arca Securities also operates as a facility of NYSE and similarly provides outbound routing from NYSE to other market centers, subject to conditions similar to those listed above.<sup>13</sup>

Currently, the operation of Arca Securities as a facility of NYSE Arca and NYSE providing outbound routing services from those exchanges is subject, respectively, to NYSE Arca and NYSE oversight, as well as Commission oversight. NYSE Arca and NYSE are each responsible for ensuring that Arca Securities is operated consistent with Section 6 of the Act and their respective rules. In addition, NYSE Arca and NYSE, respectively, must file with the Commission rule changes and fees relating to Arca Securities.

Recognizing that the Commission has previously expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange to which it is routing orders, NYSE Arca proposes to accept inbound orders that its affiliate, Arca Securities, routes in its capacity as a facility of NYSE, subject to the following limitations and conditions:

- First, NYSE Arca states that FINRA and NYSE Arca have entered into an agreement pursuant to Rule 17d-2 under the Act. Pursuant to this agreement, FINRA is allocated regulatory responsibilities to review Arca Securities' compliance with certain NYSE Arca rules.<sup>14</sup> NYSE Arca, however, retains

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<sup>12</sup> Id.

<sup>13</sup> See PO Plus Notice, supra note 3, at notes 19-21 and accompanying text. See also Securities Exchange Act Release No. 55590 (April 5, 2007), 72 FR 18707 (April 13, 2007) (SR-NYSE-2007-29) (order filed for immediate effectiveness to among other things, establish a mechanism to route orders from NYSE to away market centers).

<sup>14</sup> NYSE Arca also states that Arca Securities is subject to independent oversight by FINRA, its Designated Examining Authority, for compliance with financial responsibility requirements. See PO Plus Notice, supra note 3, at section II.A.1.c.

ultimate responsibility for enforcing its rules with respect to Arca Securities.

- Second, NYSE Regulation<sup>15</sup> will monitor Arca Securities for compliance with NYSE Arca's trading rules, and will collect and maintain certain related information.<sup>16</sup>
- Third, NYSE Arca states that NYSE Regulation has agreed with NYSE Arca that it will provide a report to NYSE Arca's CRO, on a quarterly basis, that: (i) quantifies all alerts (of which NYSE Regulation is aware) that identify Arca Securities as a participant that has potentially violated NYSE Arca or Commission rules, and (ii) quantifies the number of all investigations that identify Arca Securities as a participant that has potentially violated NYSE Arca or Commission rules.<sup>17</sup>
- Fourth, NYSE Arca proposes new Rule 14.3(e) that will require NYSE Euronext, as the holding company owning both NYSE Arca and Arca Securities, to establish and maintain procedures and internal controls reasonably designed to ensure that Arca Securities does not develop or implement changes to its system, based on

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<sup>15</sup> NYSE Regulation is a wholly owned subsidiary of the NYSE that performs the regulatory functions of the NYSE pursuant to a delegation agreement. NYSE Regulation also performs many of the regulatory functions of NYSE Arca pursuant to a regulatory services agreement. See Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) ("NYSE/Arca Order") at 11255.

<sup>16</sup> Specifically, NYSE Regulation "will collect and maintain the following information of which NYSE Regulation staff becomes aware – namely, all alerts, complaints, investigations and enforcement actions where Arca Securities (in its capacity as a facility of NYSE, routing orders to NYSE Arca) is identified as a participant that has potentially violated NYSE Arca or applicable SEC rules – in an easily accessible manner so as to facilitate any review conducted by the SEC's Office of Compliance Inspections and Examination." See PO Plus Notice, supra note 3, at section II.A.1.c.

<sup>17</sup> See id.

non-public information obtained regarding planned changes to the NYSE Arca systems as a result of its affiliation with NYSE Arca, until such information is available generally to similarly situated members of NYSE Arca, in connection with the provision of inbound order routing to NYSE Arca.<sup>18</sup>

- Fifth, NYSE Arca proposes that routing from Arca Securities to NYSE Arca, in Arca Securities's capacity as a facility of NYSE, be authorized for a pilot period of twelve months.<sup>19</sup>

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>20</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>21</sup> which requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

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<sup>18</sup> See proposed NYSE Arca Equities Rule 14.3(e).

<sup>19</sup> See PO Plus Notice, supra note 3, at section II.A.1.(e).

<sup>20</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>21</sup> 15 U.S.C. 78f(b)(5).

In the past, the Commission has expressed concern that the affiliation of an exchange with one of its members raises potential conflicts of interest, and the potential for unfair competitive advantage.<sup>22</sup> Although the Commission continues to be concerned about potential unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, for the reasons discussed below, the Commission believes that it is consistent with the Act to permit Arca Securities to provide inbound routing to NYSE Arca, on a pilot basis, subject to the conditions described above.<sup>23</sup>

NYSE Arca has proposed five conditions applicable to Arca Securities routing activities, which are enumerated above. The Commission believes that these conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that FINRA's oversight of Arca Securities,<sup>24</sup> combined with NYSE

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<sup>22</sup> See, e.g., Securities Exchange Act Release No. 54170 (July 18, 2006), 71 FR 42149 (July 25, 2006) (SR-NASDAQ-2006-006) (order approving Nasdaq's proposal to adopt Nasdaq Rule 2140, restricting affiliations between Nasdaq and its members), and NYSE/Arca Order, supra note 15.

<sup>23</sup> See supra notes 14-19 and accompanying text. See also Securities Exchange Act Release No. 58680 (September 29, 2008) (SR-NYSE-2008-76) (approving the expansion of the routing of order by Arca Securities, in its capacity as a facility of NYSE Arca, to NYSE) and NYSE Alternext US Order, supra note 6 (including approval of NYSE Alternext US's affiliation with Arca Securities for purposes of Arca Securities routing orders, in its capacity as a facility of NYSE Arca and NYSE, to NYSE Alternext US).

This order approves only the routing of orders by Arca Securities, in its capacity as a facility of the NYSE, to NYSE Arca, subject to the conditions discussed herein. This approval does not include Arca Securities providing routing of orders from Amex, which will be affiliated with NYSE Arca following Amex's acquisition by NYSE Euronext, to NYSE Arca. Amex does not currently use Arca Securities to route orders to other markets and has not requested approval of such in its filing related to its acquisition by NYSE Euronext. See NYSE Alternext US Order, supra note 6.

<sup>24</sup> This oversight will be accomplished through the 17d-2 agreement among FINRA and NYSE Arca. See supra note 14 and accompanying text.

Regulation's monitoring of Arca Securities' compliance with NYSE Arca's trading rules and quarterly reporting to NYSE Arca's CRO, will help to protect the independence of NYSE Arca's regulatory responsibilities with respect to Arca Securities. The Commission also believes that proposed NYSE Arca Equities Rule 14.3(e)<sup>25</sup> is designed to ensure that Arca Securities cannot use any information advantage it may have because of its affiliation with NYSE Arca.

Furthermore, the Commission believes that NYSE Arca's proposal to allow Arca Securities to route orders inbound to NYSE Arca from NYSE, on a pilot basis, will provide NYSE Arca and the Commission an opportunity to assess the impact of any conflicts of interest of allowing an affiliated member of NYSE Arca to route orders inbound to NYSE Arca and whether such affiliation provides an unfair competitive advantage.

The Commission also finds the expansion of the PO Order consistent with the Act. The expanded PO Order will provide NYSE Arca members greater choice in the handling of their orders, and their method of compliance with their obligations under Rule 611 of Regulation NMS.<sup>26</sup>

#### IV. Accelerated Approval

NYSE Arca has asked the Commission to accelerate approval of the proposed rule change. NYSE Arca states in part that "accelerated approval...will eliminate certain competitive disadvantages that exist by permitting the Exchange to immediately offer directed orders to its Users."<sup>27</sup> The Commission finds good cause for approving the proposed rule change prior to the

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<sup>25</sup> See supra note 18 and accompanying text.

<sup>26</sup> 17 CFR 240.611.

<sup>27</sup> See Amendment No. 1, supra note 4.

thirtieth day after the date of publication of notice of filing in the Federal Register.<sup>28</sup> The Commission notes that the protections proposed by NYSE Arca, which are designed to address conflict of interest concerns identified by the Commission in connection with the inbound routing of orders to an exchange when the routing broker-dealer is an affiliate of that exchange, are consistent with those approved by the Commission in another rule filing.<sup>29</sup> The Commission also notes that the proposed rule change was published for the full 21-day comment period,<sup>30</sup> and the comment period ended on September 25, 2008. No comments were received on the proposal.

Accordingly, the Commission finds good cause for approving the proposed rule change, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.

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<sup>28</sup> 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of notice thereof, unless the Commission finds good cause for so doing.

<sup>29</sup> See NYSE Alternext US Order, supra note 6, at section III.D.2.

<sup>30</sup> See supra note 3 and accompanying text.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>31</sup> that the proposed rule change (SR-NYSEArca-2008-90), as modified by Amendment No. 1 thereto, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>32</sup>

Florence E. Harmon  
Acting Secretary

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<sup>31</sup> 15 U.S.C. 78s(b)(2).

<sup>32</sup> 17 CFR 200.30-3(a)(12).