

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51184; File No. SR-PCX-2004-129)

February 10, 2005

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Relating to Minimum Price Improvement Standards

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 29, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On January 24, 2005, PCX amended the proposal.<sup>3</sup> The Commission is publishing this notice and order to solicit comments on the proposed rule change, as amended, from interested persons and to approve the proposal on an accelerated basis.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

PCX, through its wholly owned subsidiary, PCX Equities, Inc. ("PCXE"), proposes to modify Commentary .05 to PCXE Rule 7.6(a) to provide for order entry and trading of securities in sub-penny increments. The Exchange also proposes to modify Commentary .01 to PCXE Rule 6.16 to clarify that, for all securities traded pursuant to Commentary .05 to PCXE Rule 7.6(a), the minimum amount of price improvement necessary to execute an incoming marketable order on a proprietary basis is \$0.01. The text of the proposed rule change is available on the

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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> In the amendment ("Amendment No. 1"), PCX made technical changes to the proposed rule text.

Exchange's Web site (<http://www.pacificex.com>), at the Exchange's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

As part of its continuing efforts to enhance participation on its Archipelago Exchange ("ArcaEx") facility, PCX is proposing to extend its request for exemptive relief for rounding sub-penny quotes and trades to securities that are priced greater than \$1.00. PCX has requested this extension until June 30, 2005. Recently, PCX was granted exemptive relief for rounding sub-penny prices for securities priced less than \$1.00.<sup>4</sup> In accordance with that exemption, Commentary .05 to PCXE Rule 7.6(a) was modified to reflect a sub-penny minimum price variation for securities priced less than \$1.00 on a pilot basis through September 30, 2005. The Exchange proposes adding to this commentary to allow for order entry and execution in increments smaller than \$0.01 for Nasdaq National Market ("NNM"), SmallCap, and exchange-

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<sup>4</sup> See letter from David S. Shillman, Associate Director, Division of Market Regulation ("Division"), Commission, to Mai S. Shiver, Director of Regulatory Policy, PCX, dated September 24, 2004.

listed securities. In addition, the Exchange acknowledges the Commission's concern that allowing trading in sub-penny increments could permit ArcaEx ETP Holders to trade ahead of customers by improving upon the quoted price in sub-penny increments.<sup>5</sup> Accordingly, the Exchange is also proposing to revise PCXE Rule 6.16 by providing that the minimum amount of price improvement necessary to execute an incoming marketable order on a proprietary basis by an ETP Holder when holding an unexecuted customer limit order otherwise due an execution pursuant to PCXE Rule 6.16 in that same security is \$0.01.

In conjunction with this proposal, the Exchange has requested exemptive relief that would permit, through June 30, 2005, ArcaEx's ETP Holders to provide for order entry and trading of securities traded on ArcaEx (NNM securities, SmallCap securities, and exchange-listed securities) that are executed and reported in sub-penny increments, while vendors that disseminate ArcaEx quotation information do so in penny increments.<sup>6</sup>

Further, to advance the Commission's review, and as a condition to the exemptive relief sought, the Exchange has agreed to provide the Commission with monthly reports on its activity in sub-penny increments. Such information will include reported volume of orders received and executed in sub-penny increments (in terms of both trades and shares), the execution price points, and the nature of the sub-penny orders received and executed (i.e., agency, principal, or otherwise).

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<sup>5</sup> See PCXE Rule 1.1(n).

<sup>6</sup> See letter from Mai Shiver, Director of Regulatory Policy, PCX, to Annette Nazareth, Director, Division, Commission, dated December 28, 2004. In this letter, the Exchange requested exemptive relief from Rules 11Ac1-1, 11Ac1-2, and 11Ac1-4 to allow ArcaEx, its ETP Holders, and vendors that disseminate ArcaEx quotation information to round sub-penny quotes to the nearest penny increment (up, for orders to sell; down, for orders to buy) for display purposes, while such quotes may be entered and executed in increments less than \$0.01.

The Exchange believes that allowing sub-penny executions on ArcaEx in certain securities would afford ETP Holders with trading opportunities that are consistent with those available at competing exchanges such as the National Stock Exchange and the Chicago Stock Exchange.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>7</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>8</sup> in particular, because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market, and to protect investors and the public interest.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

## III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

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<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

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](mailto:rule-comments@sec.gov). Please include File Number SR-PCX-2004-129 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-PCX-2004-129. 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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of PCX. 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 File Number SR-PCX-2004-129 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

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.<sup>9</sup> In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,<sup>10</sup> which requires that the rules of an exchange be designed to promote just and equitable principles of trade and, in general, to protect investors and the public interest.

Simultaneous with this order, the Commission is approving an exemption until June 30, 2005, from Rules 11Ac1-1, 11Ac1-2, and 11Ac1-4 under the Act<sup>11</sup> that permits ArcaEx, ETP Holders of ArcaEx, and vendors that disseminate ArcaEx quote information to enter, execute, and report quotations in exchange-listed, NNM, and SmallCap securities in increments less than \$0.01, although such quotations will be disseminated in rounded, penny increments without a rounding identifier.<sup>12</sup> The changes to Commentary .05 to PCXE Rule 7.6(a) incorporate the terms of that Commission exemption into PCXE's rules. The changes to Commentary .01 to PCXE Rule 6.16 provide that an ETP Holder must price-improve an incoming marketable order by at least \$0.01 when holding an unexecuted customer limit order otherwise due an execution pursuant to PCXE Rule 6.16(a). This is an important investor protection because an ETP Holder will be prohibited from stepping ahead of a customer limit order by a sub-penny amount even

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<sup>9</sup> In approving the proposed rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 17 CFR 240.11Ac1-1, 240.11Ac1-2, and 240.11Ac1-4.

<sup>12</sup> See letter from David S. Shillman, Associate Director, Division, Commission, to Mai S. Shiver, Director of Regulatory Policy, PCX, dated February 10, 2005.

though sub-penny orders generally may be entered on ArcaEx. The Commission notes that it previously has approved an identical price improvement standard on other exchanges.<sup>13</sup>

The Commission finds good cause for approving this proposal before the thirtieth day after the publication of notice thereof in the Federal Register. Accelerated approval will provide protection for customer limit orders simultaneous with the effectiveness of the Commission exemption that permits sub-penny quoting, for a limited period, on ArcaEx.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change, as amended (SR-PCX-2004-129), is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>13</sup> See Securities Exchange Act Release No. 44164 (April 6, 2001), 66 FR 19263 (April 13, 2001) (approving penny price improvement increment on Chicago Stock Exchange); Securities Exchange Act Release No. 46274 (July 29, 2002), 67 FR 50743 (August 5, 2002) (same for Cincinnati – now National – Stock Exchange).

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR.200.30-3(a)(12).