



# REGULATORY INFORMATION BULLETIN

**RAN-00-17**  
**June 15, 2000**

**TO: All PCX Members and Member Organizations**

**FROM: Department of Regulatory Policy**

**SUBJECT: Competing Specialist Program**  
**(File No. SR-PCX-99-07)**

On May 9, 2000, the SEC approved the Exchange's proposal to adopt a Competing Specialist Program on the PCX. The rule change, when implemented, will allow one or more competing specialists to make markets in a security, in addition to the existing regular specialists. Like regular specialists, competing specialists in a security will be required to make a continuous two-sided market and will be subject to the rights and responsibilities of regular specialists (with certain exceptions). The rule change adopts new procedures for Competing Specialists relating to the application process, qualification standards, order routing and overall scope of the program. It also modifies the current PCX rules on priority of bids and offers, trading halts and suspensions, and functionality of the P/COAST system.

Pursuant to the SEC's approval order, implementation of the Competing Specialist Program is contingent upon certain technology changes to P/COAST. Members will be notified when the Exchange will begin accepting applications to participate in the Program.

Following is the text of the rule change that the SEC approved. Questions regarding this Bulletin may be directed to Michael Pierson at (415) 393-4107, Peter Armstrong at (415) 393-4232, or Mike Rountree at (213) 977-4566.

## **EXHIBIT A**

### **Text of the Rule Change:<sup>1</sup> Competing Specialists Program**

#### **Priority and Precedence of Bids and Offers**

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<sup>1</sup> New text is underscored.

Rules 7.19(a)-(b) – No change.

Rule 7.19(c)(1) *Priority of Bids and Offers*. When a bid or offer is clearly established as the first made at a particular price ~~regardless of the floor~~, the maker shall be entitled to priority and shall have precedence on the next sale at that price, up to the number of shares of stock or principal amount of bonds specified in the bid or offer irrespective of the number of shares of stock or principal amount of bonds specified in such bid or offer. Specialist bids and offers must always yield to agency orders being represented at the same price, unless otherwise provided in the Rules of the Corporation.

An ETP Holder having priority on the floor with a bid or offer may not increase the size of his bid or offer if objection is made by another member. By placing his order with the specialist he may maintain his priority, but in an amount no greater than originally bid for or offered by him on the Floor. Orders so placed may be accepted as and retain the status of open orders if so designated at the time of placement but shall not gain priority over orders existing in the Consolidated Limit Order Book ~~specialist's book~~ at the time the ETP Holder secured the Floor with his original bid or offer.

(2) Priority Among Specialists. If two or more specialists are quoting at the NBBO and there are no agency orders being represented at the same price, the earliest specialist bid or offer at that price will have time priority and will be eligible for an execution first up to its specified size. When no specialists are quoting at the NBBO, a specialist who is representing an order may execute that order in the same security at the NBBO or better.

*Commentary:*

.01 -- No change.

.02 The term “NBBO,” as used in Rule 7.19(c), refers to the national best bid or offer made by an Intermarket Trading System (ITS) participant.

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### **Procedures for the Competing Specialist Program**

Rule 7.30(a) Reserved The following are procedures for the Competing Specialist Program.

(1) Only Registered Specialists may act as Competing Specialists. For purposes of this Rule, a “regular Specialist” is a Registered Specialist who is not a Competing Specialist.

(2) Applications for Registration as a Competing Specialist must be directed to the Corporation in writing and must list in order of preference the issue(s) in which the applicant intends to compete. The Corporation will consider the following factors in reviewing an application:

(A) financial capability;

(B) adequacy of staffing on the Floor;

(C) current and recent performance evaluations of the applicant;

(D) whether the allocation will result in increased competition in the issue and/or increased order flow to the Corporation; and

(E) objections, if any, of the regular Specialists in the issue as to whether the issue should be traded on a Competing Specialist basis.

The denial of an application for registration as a Competing Specialist may be appealed pursuant to Rule 10.14(a).

(3) All applicants must be registered as ETP Holders or ETP Firms with the Corporation and must meet the net capital requirements of SEC Rule 15c3-1 and the capital requirements set forth in Rule 4.2(b) of the Rules of the Corporation and must conform to all other performance requirements and standards set forth in the Rules of the Corporation. All applicants who control, are controlled by, or are under common control with another person engaged in a securities or related business must have and maintain appropriate information barriers, pursuant to Rule 7.44, as approved by a self-regulatory organization. A Competing Specialist will be subject to all the rules and policies applicable to a regular Specialist, unless otherwise indicated.

(4) All applicant organizations, existing or newly created, must satisfy the Corporation that they have sufficient staffing to enable them to fulfill the functions of a specialist in all of the issues in which the applicant will be registered as a Competing Specialist.

(5) Order flow not specifically designated for a Competing Specialist must be routed to a regular Specialist. In addition, an ETP Firm that is affiliated with a Regular or Competing Specialist in an issue must designate all PCX order flow to that Specialist in that issue.

(6) In a competitive situation, if the Competing Specialist organization that received approval to compete desires to terminate the competition by requesting that it be relieved of the

stock that is the subject of the competition, it must so notify the Corporation at least three (3) business days prior to the desired effective date of such withdrawal, except in those situations when such notice is not practicable.

(7) Any Competing Specialist that withdraws its registration in an issue will be barred from applying to compete in that same issue for a period of ninety (90) days following the effective date of withdrawal.

(8) Notwithstanding the existence of Competing Specialist situations, there is only one PCX market in a security subject to competition. Competitors must cooperate with the regular Specialists regarding openings and reopenings to ensure that they are unitary.

(9) All limit orders not immediately executable that are sent to a Competing Specialist must be entered directly into the Consolidated Limit Order Book and be executed according to the Corporation's rules on time priority.

(10) Competing Specialists in an issue may not suspend trading pursuant to Rule 7.46(b)(1). All suspensions of trading made must be coordinated through a regular Specialist.

(11) The registration of any Competing Specialist may be suspended or terminated by the Corporation upon a determination of any substantial or continued failure by such Competing Specialist to engage in dealing in accordance with the Bylaws, Rules and procedures of the Corporation.

(12) The Corporation will establish an effective date for competition to commence. Since the Corporation cannot know what the impact of competition will be on its marketplace, it will limit competition during the initial phase as follows:

(A) Any Registered Specialist may apply to become a Competing Specialist in a number of issues, not to exceed ten, that has been previously established for the program by the Board of Directors.

(B) The Board of Directors will determine the total number of Competing Specialists permitted on the Corporation.

(C) The Corporation will conduct a quarterly review of each Competing Specialist on the Corporation. In conducting such reviews, the Corporation may consider, among other things, the factors set forth in subsection (2), above.

(13) Once the program has operated for one year, the Corporation will evaluate it and make a recommendation to the Board of Directors as to whether to continue the program or to modify its terms.

Commentary:

.01 If a particular Specialist is not specified by the P/COAST order routing parameters for the receipt of an order, the order must be directed to a regular Specialist. However, if a routing firm is affiliated with a regular or Competing Specialist, that firm may not route orders to another specialist, but must route them to that ETP Firm's affiliated specialist, thereby preventing member firms affiliated with a specialist from routing non-profitable orders to another specialist when market conditions are unfavorable.

.02 All limit orders must be represented and executed in accordance with the Corporation's rules on time priority. Incoming orders are first executed against any contra-side limit orders on the Corporation. All market and marketable limit orders are exposed to the Specialist for possible price improvement before execution. Specialists may execute their designated order flow unless there is a contra-side limit order eligible for execution on the Corporation or another Specialist has a bid or offer with time priority at the NBBO.

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**Trading Halts and Suspensions**

Rule 7.46(a) – No change.

(b) *Suspension of Trading.*

(1) – No change.

(A) – No change.

(B) ~~to the specialist~~ all other specialists trading the security on the other  
~~Floor~~ who also shall suspend trading,

(C)-(D) – No change.

(2) – No change.

(A) – No change.

(B) to all other specialists trading the security ~~the other Floor~~ who also shall suspend trading,

(C)-(D) – No change.

Commentary:

.01 Competing Specialists in an issue may not suspend trading pursuant to this rule. All suspensions of trading must be coordinated through a regular Specialist.

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**Pacific Computerized Order Access System (“P/COAST”)**

Rule 7.70(a). *General Provisions.* P/COAST, a securities . . . [No change to remainder of this paragraph]

ETP Holders, Equity ASAP Holders and ETP Firms wishing to participate in P/COAST may do so by entering, through direct connections with the Corporation or through an ETP Holder through the facilities of the Corporation market and limit orders up to the maximum number of shares in securities traded under P/COAST as shall be fixed by the Corporation from time to time. The Corporation routes orders to a specialist in one city or the other based on arrangements that the specialists have previously made with firms that send orders to the Corporation. For orders for which no specialist has made specific arrangements with the firm sending the order, the Corporation will generally assure that the orders are transmitted to the two regular specialists on an alternating basis (e.g., the first order goes to Specialist A, the next order to Specialist B, the next to Specialist A, etc.) Specialists who accept orders pursuant to these routing procedures are obligated to represent those orders pursuant to Rule 7.24.

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Rule 7.70(h) P/COAST will assure that incoming orders will execute first against any matching agency orders with priority and then against any specialist interest with priority. Unfilled portions of such orders will default to the specialist who receives them according to previously-established routing procedures. P/COAST will continue to designate orders for representation by the specialist who has been specified to represent them according to pre-defined routing parameters (such as because the order-sending firm designated the specialist), even if another specialist has priority under Rule 7.19(c). Once P/COAST receives a market or marketable limit order, if another

specialist in that security has a bid or offer with priority at the NBBO, the system will “lock in” the execution match so that the contra specialist will be guaranteed an execution, unless the receiving specialist executes the order at a price superior to the NBBO. For example, assume that there are five PCX specialists (A, B, C, D and E) each bidding \$20 for 500 shares for their own accounts. The specialists’ quotes have time priority in the following order: A, B, C, D, E. There are no agency orders to buy at 20 on the PCX, and 20 is the national best bid. E’s customer sends a market order to the PCX to sell 5,000 shares. The order will be represented by E. The order will be displayed for up to 15 seconds on E’s auto-ex window. E may execute the entire order at 20-1/16. However, the system will lock in A’s, B’s, C’s, D’s and E’s bids, so that if any trades at \$20 occur on the PCX, they will be executed in time priority order. If E moves the order into the manual-ex window, then A, B, C and D will receive a 30-second shadow message of the order. Their outstanding bids remain locked in, unless updated so that they no longer match with the original order. However, A, B, C and D can improve the price of their proprietary quotes, and these will become locked in, as long as the original order remains in E’s manual-ex window. To change the example, if A were bidding \$20 for 5,000 shares (with priority, and B, C and D were bidding \$19-7/8), E can keep the order by filling it at 20-1/16; otherwise, if the order is filled at \$20, A can fill the entire order. If E moves the order into E’s manual-ex window, A will receive a shadow message (but B, C and D will not).