

II. Background

Nasdaq has operated Primex as a facility of the NASD since December 17, 2001. Primex operates as a Pilot Trading System pursuant to a temporary, two-year exemption from the rule filing requirements of Section 19(b) of the Act¹⁰ under Rule 19b-5 under the Act.¹¹ Nasdaq represents that Primex has exceeded the volume threshold required to maintain its status as a Pilot Trading System pursuant to Rule 19b-5 under the Act.¹² Accordingly, Nasdaq now seeks permanent approval of the Primex rules. Pending such approval, the NASD submitted a proposed rule change setting forth the rules governing Primex and permitting Nasdaq to continue to operate Primex on a temporary basis.¹³

III. Brief Description of Primex¹⁴

Participants

Primex is a voluntary system available to any NASD member and other entities that a member chooses to sponsor. To access the System, a member must be in good standing and have executed the necessary agreements with Nasdaq. Members granted access to the System are referred to as Primex Auction System Participants ("Participants"), and can access Primex for their customers or for themselves. Entities that are not members can access the System by becoming a Sponsored Subscriber of a Participant ("Sponsored Subscriber"). The Participant assumes responsibility for all activity conducted through the System by the Sponsored Subscriber.

There are two categories of Primex Participants: Primex Auction Market Makers ("PAMMs") and Crowd Participants. By becoming a Participant, a member automatically receives the right to trade as a Crowd Participant for any security eligible for trading in the System. In general, Crowd Participants can view all orders exposed in the System; interact with any order in the System; submit orders to the System; and trade as principal, agent, or riskless principal. In addition, PAMMs are entitled to exercise certain matching rights that allow a PAMM to commit

capital to its customer orders in conjunction with the order exposure process; provide execution guarantees for its own customer orders submitted to the System; and use certain types of orders that permit the PAMM to facilitate block trades and "clean crosses." PAMMs are also entitled to share in transaction revenue paid by other Participants when those other Participants execute against a PAMM's customer orders.

To become a PAMM, a member must register as such with Nasdaq for each security in which the member wishes to trade in such capacity. Members that seek to become PAMMs also must be registered as Nasdaq market makers with respect to Nasdaq-listed securities (*i.e.*, Nasdaq National Market® and The Nasdaq SmallCap MarketSM securities) or Consolidated Quotation Services ("CQS") market makers with respect to exchange-listed securities. With respect to any security eligible for which a Participant is registered as a PAMM, such PAMM must submit to the System a minimum percentage¹⁵ of its Mandatory Eligible¹⁶ public customer orders (including customer orders of another broker-dealer that directs such orders to the PAMM) for those securities in which it is registered as a PAMM.

Orders

Participants may submit unpriced market orders, as well as orders that have specified, fixed prices that are marketable or priced between the NBBO. Orders can be submitted in any round lot or mixed lot, but odd lot orders are not accepted. Fixed price orders are eligible only for "immediate or cancel" treatment.

Participants can choose the maximum duration of the exposure for their orders. Unpriced market orders generally have a default maximum broadcast period of 15 seconds, but executions can take place sooner if there are satisfactory responses from the crowd at any time during the exposure of the order. Executions can occur instantaneously when there is crowd trading interest residing in the System. Trading interest can reside in the System when Participants define their interest in advance of an order being placed, or when other, contra side orders are already in the process of being exposed. In addition, Participants also may elect to have the order exposed for an immediate or "zero second" execution, depending on the size of the

order or, as described below, guarantee an execution by committing liquidity in the absence of satisfactory interest from the crowd. Transactions always are executed at or within the NBBO.

An order also can be submitted with a condition attached requiring a minimum amount of price improvement relative to the current NBBO at the time of execution. A Participant utilizing this feature for an order to buy would specify, when entering the order into the System, that the order be executed only if the exposure yields an execution with price improvement of 3 cents below the "Best Offer" as publicly displayed in the NBBO at the time of execution.

PAMMs are entitled to attach certain match parameters to customer orders they submit to the System. For example, a PAMM may submit a customer order with a 50% match parameter. Any interest provided by the crowd is matched in both size and price by a corresponding execution with the PAMM. The PAMM must be willing to execute the entire order when using this match parameter, in the absence of sufficient response from the crowd.

PAMMs also can submit customer orders with a Two Cent Match parameter. This function allows the PAMM entering the order to execute the customer order, provided it is willing to match the price established by the crowd for the entire order to the extent the price offered by the crowd is within two cents of the NBBO. If there is crowd interest willing to provide more than two cents of price improvement, the PAMM loses that portion of the order to the crowd.

PAMMs also are entitled to provide execution guarantees within the System. This feature ensures that any balance of an order remaining after exposing it to the crowd will receive a liquidity guarantee, established by the PAMM for each order submitted, at a price at least as good as the NBBO at that time.

Any condition, match parameter, or guarantee must be attached to an order at the time it is submitted to the System. The existence of any condition, match parameter, or guarantee that may be attached to an order is never communicated or displayed to the crowd.

The System also provides participants the option of having the balance of an unexecuted order returned to them or forwarded to other Nasdaq systems for execution. Participants must indicate their preference upon submission of an order to the System. For example, a Participant can submit an order with an indication that it should be forwarded to another Nasdaq system if the order is

¹⁰ 15 U.S.C. 78s(b).

¹¹ 17 CFR 240.19b-5.

¹² 17 CFR 240.19b-5. *See* Securities Exchange Act Release No. 45983 (May 23, 2002), 67 FR 38152 ("Original Proposal").

¹³ Notice of the filing and the immediate effectiveness of the proposed rule change was published on May 31, 2002 in the **Federal Register**. *See* Securities Exchange Act Release No. 45982 (May 23, 2002), 67 FR 38163.

¹⁴ *See* the Original Proposal for a more detailed description of Primex and the NASD Rules governing Primex.

¹⁵ *See* proposed NASD Rule 5020.

¹⁶ *See* proposed NASD Rule 5011 (definition of "Mandatory Eligible Order") and proposed NASD Rule 5020.