

either of these systems, depending on whether the security is eligible for SuperSoes or SuperMontage. Nasdaq states that the functionality for routing orders to either SuperSoes or SuperMontage generally is the same. Only orders that are marked for routing outside Primex will be routed to SuperSoes or SuperMontage, and only after the order has been exposed in Primex and an unexecuted balance remains. While only Market Orders can be routed to SuperSoes, both Fixed Price Orders²⁴ and Market Orders will be eligible for routing to SuperMontage. Orders routed to SuperMontage will be considered as immediate or cancel orders.

To permit Primex to operate more efficiently with SuperMontage, Nasdaq also modified the System to allow it to accept orders with AIQ and AON conditions. These conditions can be attached to orders submitted to SuperMontage, but Primex originally was not designed to accept these types of orders. The AIQ functionality, when selected, can preclude an order from executing against proprietary interest from the same firm. The AIQ condition may be applied to orders, responses and indications. The function is designed to prevent intra-firm trades that may not be permissible for certain types of accounts, such as those subject to ERISA or an investment advisory relationship.

The AON functionality allows Primex subscribers to place a condition on certain orders that ensures the order will be executed in its entirety or not at all. The AON condition can be used for orders that the subscriber exposes for a "zero-second" auction.

Finally, Nasdaq is modifying the language in proposed NASD Rule 5020 to reflect that it has delayed for an additional calendar quarter the rule implementing the requirement that PAMMs submit a certain percentage of Mandatory Eligible Orders²⁵ to the System to be eligible for certain features of the System (the "percentage test"). Some firms, especially those that are now expected to participate in Primex because the anonymity feature has been removed, need to reprogram their internal systems to make Primex an order routing destination. Nasdaq believes delaying the percentage test will allow firms to make these changes and gain experience with the System. The percentage test will continue to be measured on a quarterly basis. However,

the phase-in schedule was amended to implement the test starting with the calendar quarter that begins on January 1, 2003, instead of October 1, 2002. Specifically, beginning on January 1, 2003, a participant previously registered as a PAMM can retain this status if it submitted to the System 50% of its Mandatory Eligible Orders during the calendar quarter that commences on October 1, 2002. Beginning on April 1, 2003, and every calendar quarter thereafter, a PAMM can retain its status if it submits 80% of its Mandatory Eligible Orders during the previous calendar quarter.

VI. Amendment No. 3

In Amendment No. 3, Nasdaq seeks permanent approval to (1) change the minimum size requirement for Predetermined Relative Indications from a tiered structure depending on the amount of price improvement, to a standard minimum size requirement of 100 shares, regardless of the amount of price improvement offered; (2) reprogram the System to reject trading interest marked as "short" or "short exempt" in any exchange-listed security eligible for participation in the InterMarket Trading System; and (3) modify proposed NASD Rule 5017 to be consistent with the system change relating to short sales set forth in Amendment No. 2. The amended rule text follows. New language is italicized; deleted language is in brackets.

5017. Short Sales

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(a) Participants [are responsible for] *must properly identify trading interest as a long sale, short sale, or short sale exempt.* [complying with applicable short sale rules when using the Application. No Participant shall submit to the Application an order for a security that, if executed, would result in a "short sale" as that term is defined in Exchange act Rule 3b-3, unless the transaction would be exempt from, or otherwise permissible under, the requirements of NASD Rule 3350 or Exchange Act Rule 10a-1, as applicable.]

(b) *The Application will not process trading interest to sell short a Nasdaq-listed security if the execution of such trading interest will violate Rule 3350.*

(c) *The Application will reject trading interest identified as a short sale or short sale exempt in any exchange-listed security eligible for participation in the InterMarket Trading System.*

5018. Responses and Indications

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(c) Indications—Indications are instructions, with the characteristics set forth below, submitted to the Application by Participants to interact with orders exposed in an Auction. An Indication may be a Predetermined Relative Indication ("PRI") or a Go-Along Indication.

(1) Predetermined Relative Indications

(A) No changes.

(B) At the time of its original entry, each PRI submitted to the Application must be for *at least 100 shares*. [the following share amounts:

(i) NBBO PRIs must be for at least 3000 shares upon entry;

(ii) NBBO +/- .01 or .02 must be for at least 2000 shares upon entry;

(iii) NBBO +/- .03 or greater must be for at least 1000 shares upon entry.]

(C) No changes.

(D) No changes.

(E) No changes.

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Nasdaq represents that the graduated PRI size requirement was intended to make it less expensive to offer greater price improvement by requiring less of a share commitment as more price improvement was offered. Discussion with current and prospective users of Primex indicated to Nasdaq that the minimum size requirements are a disincentive to using PRIs because many of the trading strategies that would employ PRIs are most effective if the user has flexibility in the number of shares that must be committed. Nasdaq therefore proposes to eliminate the graduated, minimum size requirement and instead require a commitment of 100 shares, regardless of the amount of price improvement offered. With this change, Primex users would be able to enter PRIs for any round or mixed lot greater than 100 shares. Nasdaq believes this modification will encourage more users to submit PRIs, thus increasing the liquidity in Primex and the opportunities for price improvement.

VII. Discussion

After careful consideration, the Commission finds, for the reasons discussed below, that the proposed rule change, as amended, is consistent with the Act and the rules and regulations applicable to the NASD, a registered securities association.²⁶ We do not believe, as the NYSE suggests, that the

²⁴ The term Fixed Price Order is defined in proposed NASD Rule 5011(n) as an order submitted to Primex to purchase or sell a security at a specified, fixed price or better.

²⁵ The term "Mandatory Eligible Order" is defined in proposed NASD Rules 5011 and 5020.

²⁶ In this regard, the Commission disagrees with NYSE's argument that it must apply statutory requirements applicable to registered exchanges to Primex. The Commission notes that Nasdaq operates Primex as a facility of the NASD. The NASD is a registered securities association under Section 15A of the Act and is not a registered exchange under Section 6 of the Act. Nasdaq's application for registration as an exchange is pending with the Commission.