

Proposed Rule Change by National Association of Securities Dealers
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

<input type="checkbox"/> Initial	<input checked="" type="checkbox"/> Amendment	<input type="checkbox"/> Withdrawal	<input checked="" type="checkbox"/> Section 19(b)(2)	<input type="checkbox"/> Section 19(b)(3)(A)	<input type="checkbox"/> Section 19(b)(3)(B)
			Rule		
<input type="checkbox"/> Pilot	<input type="checkbox"/> Extension of Time Period for Commission Action	<input type="text" value=""/> Date Expires	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

<input type="checkbox"/> Exhibit 2 Sent As Paper Document	<input type="checkbox"/> Exhibit 3 Sent As Paper Document
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Description
Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name	<input type="text" value="Sharon"/>	Last Name	<input type="text" value="Zackula"/>
Title	<input type="text" value="Associate General Counsel"/>		
E-mail	<input type="text" value="sharon.zackula@nasd.com"/>		
Telephone	<input type="text" value="(202) 728-8985"/>	Fax	<input type="text" value="(202) 728-8972"/>

Signature
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date	<input type="text" value="10/11/2005"/>
By	<input type="text" value="Patrice Gliniecki"/>
	(Name)
	<input type="text" value="Senior Vice President and Deputy General Counsel"/>
	(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) Amendment No. 3 to SR-NASD-2003-141,¹ which proposes to establish a second interpretation, proposed IM-2440-2, “Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities” (“Proposed Interpretation”) to NASD Rule 2440, to provide additional mark-up guidance for transactions in debt securities, except municipal securities.² The Proposed Interpretation addresses two fundamental issues in debt securities transactions: (1) how does a dealer correctly identify the prevailing market price of a debt security; and (2) what is a “similar” security and when may it be considered in determining the prevailing market price.

This Amendment No. 3 to SR-NASD-2003-141 incorporates the changes to the proposed rule change made in Amendments No. 1 and 2 to SR-NASD-2003-141. This Amendment No. 3 proposes to: (1) provide guidance regarding the term “contemporaneous”; (2) delete the proposed provision regarding Specified Institutional

¹ See Securities Exchange Act Release No. 51338 (March 9, 2005), 70 FR 12764 (March 15, 2005) (SR-NASD-2003-141) (notice of filing of proposed rule change, including Amendment No. 1 and Amendment No. 2, and request for comments).

² Municipal Securities Rulemaking Board (MSRB) Rule G-30, “Prices and Commissions,” applies to transactions in municipal securities, and requires that a municipal securities dealer engaging in a transaction as a principal with a customer must buy or sell securities at an aggregate price that is “fair and reasonable.”

Trades added in Amendment No. 1 and, instead, provide additional flexibility to dealers to show that a dealer's contemporaneous cost or proceeds may not be indicative of prevailing market price in two additional instances -- news affecting an issuer and large or small transactions; (3) clarify the steps to establish prevailing market price when a dealer has not entered into a contemporaneous transaction; and (4) make other technical and conforming changes. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

IM-2440-1. Mark-Up Policy

* * * * *

IM-2440-2. Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities¹

(a) Scope

IM-2440-1 applies to debt securities transactions, and this IM-2440-2 supplements the guidance provided in IM-2440-1.

(b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this IM-2440-2, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with NASD pricing rules. (See, e.g., Rule 2320).

(2) When the dealer is *selling* the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous purchases* in the security or can show that in the particular circumstances the dealer's *contemporaneous cost* is not indicative of the prevailing market price. When the dealer is *buying* the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous sales* in the security or can show that in the particular circumstances the dealer's *contemporaneous proceeds* are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost or proceeds must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost or proceeds are not indicative of prevailing market price, and thus overcome the presumption, in instances

where (i) interest rates or the credit quality of the security changed significantly, or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) because the size of such transaction, either large or small, caused the transaction to be executed at a price away from the prevailing market price of the same security, as evidenced by contemporaneous transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities.

(5) In instances where the dealer has established that the dealer's cost (proceeds) are no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price, such as (i) where interest rates or the credit quality of the security changed significantly, or news issued or otherwise distributed and known to the marketplace had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) the size of the transaction, either large or small, caused the transaction to be executed away from the prevailing market price, the most important or first pricing factor that should be taken into consideration in establishing prevailing market price for a mark-up or a mark-down is prices of any contemporaneous inter-dealer transactions in the security in question. In the absence of inter-dealer transactions, the second factor that should be taken into consideration in establishing the prevailing market prices for mark-ups (mark-downs) to customers is prices of contemporaneous dealer purchases

(sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security. For actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations, may be used in the absence of inter-dealer or institutional transactions (described in the preceding sentence) in determining prevailing market price for customer mark-ups (mark-downs).

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a “similar” security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a “similar” security with institutional accounts with which any dealer regularly effects transactions in the “similar” security with respect to customer mark-ups (mark-downs);
- Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;
- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and

- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

(7) The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the transaction prices, quotes and yields described in the three factors in paragraph (b)(5) and the four factors in paragraph (b)(6) depends on the facts and circumstances surrounding the comparison transaction, such as its size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, the timeliness of the information, and, with respect to the final factor listed in paragraph (b)(6), the relative spread of the quotations in the similar security to the quotations in the subject security.

(8) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, NASD or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (e.g., discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(9) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of "similar" securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" securities taken as a whole.

(c) "Similar" securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar," as that term is used in this IM-2440-2, to the subject security may be determined by factors that include but are not limited to the following:

(A) Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is

not yet incorporated in credit ratings should be considered (e.g., changes to ratings outlooks));

(B) The extent to which the spread (i.e., the spread over U.S. Treasury securities of a similar duration) at which the “similar” security trades is comparable to the spread at which the subject security trades;

(C) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and

(D) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security’s value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

^{1.} The Interpretation does not apply to transactions in municipal securities. Single terms in parentheses within sentences, such as the terms “(sales)” and “(to)” in the phrase, “contemporaneous dealer purchases (sales) in the security in question

from (to) institutional accounts,” refer to scenarios where a member is charging a customer a mark-down.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on July 30, 2003, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The Board of Governors of NASD had an opportunity to review the proposed rule change at its meeting on July 31, 2003. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the Board of Governors of NASD to adopt NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

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

(a) Purpose

Introduction

On September 16, 2003, NASD filed with the Commission a proposed rule change to establish a second interpretation, proposed IM-2440-2, “Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities” (“Proposed Interpretation”) to NASD Rule 2440, “Fair Prices and Commissions.” The purpose of the proposed rule change is to provide additional mark-up guidance for transaction in debt securities, except municipal securities.

On June 29, 2004, NASD filed Amendment No. 1 to its filing. On February 17, 2005, NASD filed Amendment No. 2 to its filing. On October 4, 2005, NASD filed a Response to Comments to its filing. The purpose of this filing is to further amend SR-NASD-2003-141 to: (1) provide guidance regarding the term “contemporaneous;” (2) delete the proposed provision regarding Specified Institutional Trades added in Amendment No. 1 and, instead, provide additional flexibility to dealers to show that a dealer’s contemporaneous cost or proceeds may not be indicative of prevailing market price in two additional instances -- news affecting an issuer and large or small transactions; (3) clarify the steps to establish prevailing market price when a dealer has not entered into a contemporaneous transaction; and (4) make other technical and conforming changes. NASD is proposing the changes described above in (1) through (3) in this Amendment No. 3 to respond to comments filed on the proposed rule change, and

the other changes referenced above to improve clarity and ease of reference.³

Proposed Changes in Amendment No. 3

“Contemporaneous”

NASD is proposing to amend the Proposed Interpretation in response to comments that NASD should provide additional guidance on the meaning of “contemporaneous,” a concept in the term “contemporaneous cost” and in statements about contemporaneous transactions. Although what is considered “contemporaneous” for purposes of determining a mark-up (mark-down) is a facts-and-circumstances test, NASD proposes to amend the Proposed Interpretation to provide additional guidance to members on how NASD will interpret the term “contemporaneous.” In this Amendment No. 3, NASD proposes to add new paragraph (b)(3) to provide the following:

(3) A dealer’s cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer’s proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be

³ The SEC received six comments letters regarding SR-NASD-2003-141. As noted above, NASD filed a Response to Comments on October 4, 2005. The comments and NASD’s responses are detailed therein.

expected to reflect the current market price for the security.)

News Affecting An Issuer

The Proposed Interpretation requires a dealer to use its contemporaneous cost (proceeds) as the prevailing market price in calculating a mark-up (mark-down). Countervailing evidence may be considered only where the dealer made no contemporaneous purchases (sales) in the debt security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price. The Proposed Interpretation, as published for comment by the SEC, limits to three instances when a dealer may be able to shift from the dealer's own contemporaneous cost to non-contemporaneous cost values to identify the prevailing market price—significant changes in interest rates or in the credit quality of the security, and when the dealer's contemporaneous cost (proceeds) would be based on a large trade defined as a “Specified Institutional Trade.”⁴ (As discussed hereinafter, NASD is proposing to modify the provision regarding Specified Institutional Trades.)

NASD agrees with the comments that certain examples of news affecting an issuer, such as news of legislation that may affect specific issuers or industry sectors, are

⁴ In the Proposed Interpretation, a “Specified Institutional Trade” is defined as a dealer's contemporaneous trade with an institutional account with which the dealer regularly effects transactions in the same or a “similar” security, as defined in the Proposed Interpretation, and in the case of a sale to such an account, the trade was executed at a price higher than the then prevailing market price, and in the case of a purchase from such an account, the trade was executed at a price lower than the then prevailing market price, and the execution price was away from the prevailing market price because of the size and the risk of the transaction.

less clearly categorized as either a significant change in interest rate or in the credit quality of the security, but may cause price shifts in a debt security invalidating the dealer's own "contemporaneous cost" as a reliable and accurate measure of prevailing market price.⁵ In such cases, NASD agrees that the dealer should be permitted to look to non-contemporaneous cost values to establish prevailing market price. Accordingly, in this Amendment No. 3, NASD proposes to amend paragraph (b)(4) of the Proposed Interpretation to add a fourth instance – "where . . . news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security" -- where it may be appropriate for a dealer to shift from the dealer's own contemporaneous cost to a non-contemporaneous cost value to establish prevailing market price. The specific amendments that NASD proposes to paragraph (b)(4) are set forth below, following the discussion, Size of Trade/Specified Institutional Trade, of proposed amendments to paragraph (b)(4) relating to large and small trades.

Size of Trade/Specified Institutional Trade

As indicated above, countervailing evidence of prevailing market price may be considered only where the dealer made no contemporaneous purchases (sales) in the debt security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price, and the Proposed Interpretation, as published for comment by the SEC, limits to three instances—significant changes in

⁵ Examples of "news affecting an issuer" that may not be included in the two existing categories include news about pending or contemplated legislation that may affect issuers or industry sectors, particularly for bonds trading at distressed levels, such as legislative developments affecting asbestos claims and pension regulation.

interest rates or in the credit quality of the security, and a “Specified Institutional Trade” (with a fourth category, news affecting an issuer, proposed to be added, as discussed above)—where it may be appropriate for a dealer to shift from the dealer’s own contemporaneous cost to establish prevailing market price.

In Amendment No. 1 to the proposed rule change, NASD proposed that in instances of a Specified Institutional Trade, a dealer may be able to show that its contemporaneous cost (proceeds) are not indicative of prevailing market price. However, in response to the comments, NASD is now proposing to delete Specified Institutional Trades and instead provide that either a large or a small transaction executed at a price away from the prevailing market price of the security, as evidenced by certain contemporaneous transactions, is an instance where it may be appropriate for the dealer to show that its contemporaneous cost (proceeds) is not indicative of prevailing market price. The proposed change provides dealers greater flexibility to identify prevailing market price using a non-contemporaneous cost value than the provision requiring a Specified Institutional Trade proposed in Amendment No. 1 to SR-NASD-2003-141.

As a result of the proposed changes regarding news affecting an issuer and large and small trades, NASD proposes to amend paragraph (b)(4) of the Proposed Interpretation to read as follows:

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer’s own contemporaneous cost or proceeds must be prepared to provide evidence that is sufficient to overcome the

presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost or proceeds are not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates or the credit quality of the security changed significantly, or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) because the size of such transaction, either large or small, caused the transaction to be executed at a price away from the prevailing market price of the same security, as evidenced by contemporaneous transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities.

In addition, NASD is proposing conforming amendments to paragraph (b)(5) to incorporate appropriate references to news affecting an issuer and large and small transactions, and to delete the provisions relating to Specified Institutional Trades.

No Contemporaneous Transaction

In paragraph (b)(2), the Proposed Interpretation, as published for comment by the SEC, provides: "When the dealer is selling the security to a customer, countervailing

evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous purchases* in the security. . . .” (A parallel statement addresses dealer purchases from customers.) In this Amendment No. 3 to SR-NASD-2003-141, NASD is proposing to amend paragraph (b)(5) of the Proposed Interpretation to clarify that when a dealer does not have its own contemporaneous trade to reference, the process that the dealer uses to determine the prevailing market price is the same as that stated in the Proposed Interpretation in the instances where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer’s contemporaneous cost (proceeds) provide the best measure of the prevailing market price. NASD proposes to amend the first sentence of paragraph (b)(5) of the Proposed Interpretation as follows to reflect this change:

(5) In instances where the dealer has established that the dealer’s cost (proceeds) are no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer’s contemporaneous cost or proceeds provide the best measure of the prevailing market price, such as (i) where interest rates or the credit quality of the security changed significantly, or news issued or otherwise distributed and known to the marketplace had an effect on the perceived value of the debt security, after the dealer’s contemporaneous transaction, or (ii) the size of the transaction, either large or small, caused the transaction to

be executed away from the prevailing market price, the most important or first pricing factor that should be taken into consideration in establishing prevailing market price for a mark-up or a mark-down is prices of any contemporaneous inter-dealer transactions in the security in question.

Other Changes

Finally, in this Amendment No. 3, NASD proposes to number or otherwise label the provisions of the Proposed Interpretation for ease of reference. In addition, NASD proposes to amend the introductory language of paragraph (b)(7) to make clear that the caveats regarding using information other than contemporaneous cost to identify prevailing market price apply to the factors listed in both paragraph (b)(5) and paragraph (b)(6).

Effective Date

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public

interest. NASD believes that clarifying the standard for correctly identifying the prevailing market price of a debt security for purposes of calculating a mark-up (mark-down), clarifying the obligations of a member when it seeks to use a measure other than the member's own contemporaneous cost (proceeds) as the prevailing market price, and confirming that similar securities may be used in certain instances to determine the prevailing market price are measures designed to prevent fraudulent practices, promote just and equitable principles of trade, and protect investors and the public interest.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

NASD has previously responded to industry and SEC comments regarding this rule change. *See* NASD Response to Comments, filed on October 4, 2005.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

NASD requests the Commission to find good cause pursuant to Section 19(b)(2) of the Act for approving Amendment No. 3 to the proposed rule change prior to the 30th day after its publication in the Federal Register. Although not previously published, the proposed rule change seeks to modify the Proposed Interpretation in response to

comments, and the issues addressed in the proposed amendments to the Proposed Interpretation have been subject to notice and public comment as part of SR-NASD-2003-141.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 4. Changes to Rule Text from Original Filing and Subsequent Amendments.

Exhibit 5. Text of Proposed Amendments to IM-2440 and Proposed IM-2440-2.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2003-141)
SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Association of Securities Dealers, Inc.
Relating to Additional Mark-Up Policy for Transactions in Debt Securities, Except
Municipal Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on [leave space] , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) and amended on -----³ the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ This Amendment No. 3 to SR-NASD-2003-141 incorporates changes to the original rule filing made in Amendments No. 1 and No. 2. *See* Securities Exchange Act Release No. 51338 (March 9, 2005), 70 FR 12764 (March 15, 2005) (SR-NASD-2003-141) (notice of filing of proposed rule change, including Amendment No. 1 and Amendment No. 2, and request for comments). NASD Response to Comments was filed on October 4, 2005.

NASD is filing this Amendment No. 3 to SR-NASD-2003-141,⁴ which proposes adopt establish a second interpretation, proposed IM-2440-2, “Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities” (“Proposed Interpretation”) to NASD Rule 2440, to provide additional mark-up guidance for transactions in debt securities, except municipal securities.⁵ The Proposed Interpretation addresses two fundamental issues in debt securities transactions: (1) how does a dealer correctly identify the prevailing market price of a debt security; and (2) what is a “similar” security and when may it be considered in determining the prevailing market price.

This Amendment No. 3 to SR-NASD-2003-141 incorporates the changes to the proposed rule change made in Amendments No. 1 and 2 to SR-NASD-2003-141. This Amendment No. 3 proposes to: (1) provide guidance regarding the term “contemporaneous”; (2) delete the proposed provision regarding Specified Institutional Trades added in Amendment No. 1 and, instead, provide additional flexibility to dealers to show that a dealer’s contemporaneous cost or proceeds may not be indicative of prevailing market price in two additional instances -- news affecting an issuer and large or small transactions; (3) clarify the steps to establish prevailing market price when a

⁴ See Securities Exchange Act Release No. 51338 (March 9, 2005), 70 FR 12764 (March 15, 2005) (SR-NASD-2003-141).

⁵ Municipal Securities Rulemaking Board (MSRB) Rule G-30, “Prices and Commissions,” applies to transactions in municipal securities, and requires that a municipal securities dealer engaging in a transaction as a principal with a customer must buy or sell securities at an aggregate price that is “fair and reasonable.”

dealer has not entered into a contemporaneous transaction; and (4) make other technical and conforming changes. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

IM-2440-1. Mark-Up Policy

* * * * *

IM-2440-2. Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities¹

(a) Scope

IM-2440-1 applies to debt securities transactions, and this IM-2440-2 supplements the guidance provided in IM-2440-1.

(b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this IM-2440-2, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with NASD pricing rules. (See, e.g., Rule 2320).

(2) When the dealer is selling the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases in the security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price. When the dealer is buying the security from a

customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous sales* in the security or can show that in the particular circumstances the dealer's *contemporaneous proceeds* are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost or proceeds must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost or proceeds are not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates or the credit quality of the security changed significantly, or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) because the size of such transaction, either

large or small, caused the transaction to be executed at a price away from the prevailing market price of the same security, as evidenced by contemporaneous transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities.

(5) In instances where the dealer has established that the dealer's cost (proceeds) are no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price, such as (i) where interest rates or the credit quality of the security changed significantly, or news issued or otherwise distributed and known to the marketplace had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) the size of the transaction, either large or small, caused the transaction to be executed away from the prevailing market price, the most important or first pricing factor that should be taken into consideration in establishing prevailing market price for a mark-up or a mark-down is prices of any contemporaneous inter-dealer transactions in the security in question. In the absence of inter-dealer transactions, the second factor that should be taken into consideration in establishing the prevailing market prices for mark-ups (mark-downs) to customers is prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security. For actively traded securities, contemporaneous bid (offer) quotations for the security in question

made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations, may be used in the absence of inter-dealer or institutional transactions (described in the preceding sentence) in determining prevailing market price for customer mark-ups (mark-downs).

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a “similar” security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a “similar” security with institutional accounts with which any dealer regularly effects transactions in the “similar” security with respect to customer mark-ups (mark-downs);
- Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;
- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

(7) The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the transaction prices, quotes and yields described in the three factors in paragraph (b)(5) and the four factors in paragraph (b)(6) depends on the facts and circumstances surrounding the comparison transaction, such as its size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, the timeliness of the information, and, with respect to the final factor listed in paragraph (b)(6), the relative spread of the quotations in the similar security to the quotations in the subject security.

(8) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, NASD or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (e.g., discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(9) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering

yields of “similar” securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in “similar” securities taken as a whole.

(c) “Similar” securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar," as that term is used in this IM-2440-2, to the subject security may be determined by factors that include but are not limited to the following:

(A) Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as “similar” securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (e.g., changes to ratings outlooks));

(B) The extent to which the spread (i.e., the spread over U.S. Treasury securities of a similar duration) at which the “similar” security trades is comparable to the spread at which the subject security trades;

(C) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and

(D) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security’s value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

^{1.} The Interpretation does not apply to transactions in municipal securities. Single terms in parentheses within sentences, such as the terms “(sales)” and “(to)” in the phrase, “contemporaneous dealer purchases (sales) in the security in question

from (to) institutional accounts,” refer to scenarios where a member is charging a customer a mark-down.

* * * * *

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

In its filing with the Commission, NASD 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 IV below. NASD 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

Introduction

On September 16, 2003, NASD filed with the Commission a proposed rule change to establish a second interpretation, proposed IM-2440-2, “Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities” (“Proposed Interpretation”) to NASD Rule 2440, “Fair Prices and Commissions.” The purpose of the proposed rule change is to provide additional mark-up guidance for transaction in debt securities, except municipal securities.

On June 29, 2004, NASD filed Amendment No. 1 to its filing. On February 17, 2005, NASD filed Amendment No. 2 to its filing. On October 4, 2005, NASD filed a Response to Comments to its filing. The purpose of this filing is to further amend SR-

NASD-2003-141 to: (1) provide guidance regarding the term “contemporaneous;” (2) delete the proposed provision regarding Specified Institutional Trades added in Amendment No. 1 and, instead, provide additional flexibility to dealers to show that a dealer’s contemporaneous cost or proceeds may not be indicative of prevailing market price in two additional instances -- news affecting an issuer and large or small transactions; (3) clarify the steps to establish prevailing market price when a dealer has not entered into a contemporaneous transaction; and (4) make other technical and conforming changes. NASD is proposing the changes described above in (1) through (3) in this Amendment No. 3 to respond to comments filed on the proposed rule change, and the other changes referenced above to improve clarity and ease of reference.⁶

Proposed Changes in Amendment No. 3

“Contemporaneous”

NASD is proposing to amend the Proposed Interpretation in response to comments that NASD should provide additional guidance on the meaning of “contemporaneous,” a concept in the term “contemporaneous cost” and in statements about contemporaneous transactions. Although what is considered “contemporaneous” for purposes of determining a mark-up (mark-down) is a facts-and-circumstances test, NASD proposes to amend the Proposed Interpretation to provide additional guidance to members on how NASD will interpret the term “contemporaneous.” In this Amendment No. 3, NASD proposes to add new paragraph (b)(3) to provide the following:

⁶ The SEC received six comments letters regarding SR-NASD-2003-141. As noted above, NASD filed a Response to Comments on October 4, 2005. The comments and NASD’s responses are detailed therein.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

News Affecting An Issuer

The Proposed Interpretation requires a dealer to use its contemporaneous cost (proceeds) as the prevailing market price in calculating a mark-up (mark-down). Countervailing evidence may be considered only where the dealer made no contemporaneous purchases (sales) in the debt security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price. The Proposed Interpretation, as published for comment by the SEC, limits to three instances when a dealer may be able to shift from the dealer's own contemporaneous cost to non-contemporaneous cost values to identify the prevailing market price—significant changes in interest rates or in the credit quality of the security, and when the dealer's contemporaneous cost (proceeds) would be based on a large trade

defined as a “Specified Institutional Trade.”⁷ (As discussed hereinafter, NASD is proposing to modify the provision regarding Specified Institutional Trades.)

NASD agrees with the comments that certain examples of news affecting an issuer, such as news of legislation that may affect specific issuers or industry sectors, are less clearly categorized as either a significant change in interest rate or in the credit quality of the security, but may cause price shifts in a debt security invalidating the dealer’s own “contemporaneous cost” as a reliable and accurate measure of prevailing market price.⁸ In such cases, NASD agrees that the dealer should be permitted to look to non-contemporaneous cost values to establish prevailing market price. Accordingly, in this Amendment No. 3, NASD proposes to amend paragraph (b)(4) of the Proposed Interpretation to add a fourth instance – “where . . . news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security” -- where it may be appropriate for a dealer to shift from the dealer’s own contemporaneous cost to a non-contemporaneous cost value to establish prevailing

⁷ In the Proposed Interpretation, a “Specified Institutional Trade” is defined as a dealer’s contemporaneous trade with an institutional account with which the dealer regularly effects transactions in the same or a “similar” security, as defined in the Proposed Interpretation, and in the case of a sale to such an account, the trade was executed at a price higher than the then prevailing market price, and in the case of a purchase from such an account, the trade was executed at a price lower than the then prevailing market price, and the execution price was away from the prevailing market price because of the size and the risk of the transaction.

⁸ Examples of “news affecting an issuer” that may not be included in the two existing categories include news about pending or contemplated legislation that may affect issuers or industry sectors, particularly for bonds trading at distressed levels, such as legislative developments affecting asbestos claims and pension regulation.

market price. The specific amendments that NASD proposes to paragraph (b)(4) are set forth below, following the discussion, Size of Trade/Specified Institutional Trade, of proposed amendments to paragraph (b)(4) relating to large and small trades.

Size of Trade/Specified Institutional Trade

As indicated above, countervailing evidence of prevailing market price may be considered only where the dealer made no contemporaneous purchases (sales) in the debt security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price, and the Proposed Interpretation, as published for comment by the SEC, limits to three instances—significant changes in interest rates or in the credit quality of the security, and a “Specified Institutional Trade” (with a fourth category, news affecting an issuer, proposed to be added, as discussed above)—where it may be appropriate for a dealer to shift from the dealer's own contemporaneous cost to establish prevailing market price.

In Amendment No. 1 to the proposed rule change, NASD proposed that in instances of a Specified Institutional Trade, a dealer may be able to show that its contemporaneous cost (proceeds) are not indicative of prevailing market price. However, in response to the comments, NASD is now proposing to delete Specified Institutional Trades and instead provide that either a large or a small transaction executed at a price away from the prevailing market price of the security, as evidenced by certain contemporaneous transactions, is an instance where it may be appropriate for the dealer to show that its contemporaneous cost (proceeds) is not indicative of prevailing market price. The proposed change provides dealers greater flexibility to identify prevailing

market price using a non-contemporaneous cost value than the provision requiring a Specified Institutional Trade proposed in Amendment No. 1 to SR-NASD-2003-141.

As a result of the proposed changes regarding news affecting an issuer and large and small trades, NASD proposes to amend paragraph (b)(4) of the Proposed Interpretation to read as follows:

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost or proceeds must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost or proceeds are not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates or the credit quality of the security changed significantly, or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) because the size of such transaction, either large or small, caused the transaction to be executed

at a price away from the prevailing market price of the same security, as evidenced by contemporaneous transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities.

In addition, NASD is proposing conforming amendments to paragraph (b)(5) to incorporate appropriate references to news affecting an issuer and large and small transactions, and to delete the provisions relating to Specified Institutional Trades.

No Contemporaneous Transaction

In paragraph (b)(2), the Proposed Interpretation, as published for comment by the SEC, provides: “When the dealer is selling the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous purchases* in the security. . . .” (A parallel statement addresses dealer purchases from customers.) In this Amendment No. 3 to SR-NASD-2003-141, NASD is proposing to amend paragraph (b)(5) of the Proposed Interpretation to clarify that when a dealer does not have its own contemporaneous trade to reference, the process that the dealer uses to determine the prevailing market price is the same as that stated in the Proposed Interpretation in the instances where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer’s contemporaneous cost (proceeds) provide the best measure of the prevailing market price. NASD proposes to amend the first sentence of paragraph (b)(5) of the Proposed Interpretation as follows to reflect this change:

(5) In instances where the dealer has established that the dealer's cost (proceeds) are no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price, such as (i) where interest rates or the credit quality of the security changed significantly, or news issued or otherwise distributed and known to the marketplace had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) the size of the transaction, either large or small, caused the transaction to be executed away from the prevailing market price, the most important or first pricing factor that should be taken into consideration in establishing prevailing market price for a mark-up or a mark-down is prices of any contemporaneous inter-dealer transactions in the security in question.

Other Changes

Finally, in this Amendment No. 3, NASD proposes to number or otherwise label the provisions of the Proposed Interpretation for ease of reference. In addition, NASD proposes to amend the introductory language of paragraph (b)(7) to make clear that the

caveats regarding using information other than contemporaneous cost to identify prevailing market price apply to the factors listed in both paragraph (b)(5) and paragraph (b)(6).

Effective Date

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that clarifying the standard for correctly identifying the prevailing market price of a debt security for purposes of calculating a mark-up (mark-down), clarifying the obligations of a member when it seeks to use a measure other than the member's own contemporaneous cost (proceeds) as the prevailing market price, and confirming that similar securities may be used in certain instances to determine the prevailing market price are measures designed to prevent fraudulent practices, promote just and equitable principles of trade, and protect investors and the public interest.

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

NASD does not believe that the proposed rule change will result in any burden

on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

NASD has previously responded to industry and SEC comments regarding this rule change. *See* NASD Response to Comments, filed on October 4, 2005.

III. **Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

NASD has requested that the Commission find good cause pursuant to Section 19(b)(2) of the Act for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NASD and, in particular, the requirements of Section 15A of the Act and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will benefit investors, the public, and broker-dealers in that the Proposed Interpretation is intended to prevent fraudulent and manipulative mark-up acts and practices, to promote just and equitable principles of trade in the pricing of transactions with customers, and to provide broker-dealers additional clarity and guidance regarding the pricing of debt securities transactions and the issues addressed in the proposed amendments to the Proposed Interpretation have been subject to notice and public comment previously.

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

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. Please include File Number SR-NASD-2003-141.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2003-141. 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 Room, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

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 the File Number SR-NASD-2003-141 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Secretary

⁹ 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Changes to Rule Text from Original Filing and Subsequent Amendments

IM-2440-1. Mark-Up Policy

* * * * *

IM-2440-2. Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities¹

(a) Scope

IM-2440-1 applies to debt securities transactions, and this IM-2440-2 supplements the guidance provided in IM-2440-1.

(b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this IM-2440-2, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with NASD pricing rules. (*See, e.g.,* Rule 2320).

(2) When the dealer is *selling* the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous purchases* in the security or can show that in the particular circumstances the dealer's *contemporaneous cost* is not indicative of the prevailing market price. When the dealer is *buying* the security from a customer, countervailing evidence of the prevailing market price may be

considered only where the dealer made no *contemporaneous sales* in the security or can show that in the particular circumstances the dealer's *contemporaneous proceeds* are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost or proceeds must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost or proceeds are not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates or the credit quality of the security changed significantly, or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security, after the dealer's contemporaneous [trades]transaction, or (ii) because the size of such transaction, either large or small, caused the transaction to be executed at a price away from

the prevailing market price of the same security, as evidenced by contemporaneous transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities. [(ii) the dealer's contemporaneous trade was with an institutional account with which the dealer regularly effects transactions in the same or a "similar" security, as defined below, and in the case of a sale to such account, was executed at a price higher than the then prevailing market price, or, in the case of a purchase from such account, was executed at a price lower than the then prevailing market price, and the execution price was away from the prevailing market price because of the size and risk of the transaction (a "Specified Institutional Trade"). In the case of a Specified Institutional Trade, when a dealer seeks to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price, the dealer must provide evidence of the then prevailing market price by referring exclusively to inter-dealer trades in the same security executed contemporaneously with the dealer's Specified Institutional Trade.]

(5) In instances [other than those pertaining to a Specified Institutional Trade,] where the dealer has established that the dealer's cost (proceeds) are no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price, [or] such as (i) where interest rates or the credit quality of the security changed significantly, or news issued or otherwise distributed and known to the marketplace had an effect

on the perceived value of the debt security, after the dealer's contemporaneous transaction[trades], or (ii) the size of the transaction, either large or small, caused the transaction to be executed away from the prevailing market price, the most important or first pricing factor that should be taken into consideration in establishing prevailing market price for a mark-up or a mark-down is prices of any contemporaneous inter-dealer transactions in the security in question. In the absence of inter-dealer transactions, the second factor that should be taken into consideration in establishing the prevailing market prices for mark-ups (mark-downs) to customers is prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security. For actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations, may be used in the absence of inter-dealer or institutional transactions (described in the preceding sentence) in determining prevailing market price for customer mark-ups (mark-downs).

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a “similar” security, as defined below, or prices of contemporaneous dealer

purchase (sale) transactions in a “similar” security with institutional accounts with which any dealer regularly effects transactions in the “similar” security with respect to customer mark-ups (mark-downs);

- Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;
- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

(7) [The relative weight one may attribute to these other factors]The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the transaction prices, quotes and yields described in the three factors in paragraph (b)(5) and the four factors in paragraph (b)(6) depends on the facts and circumstances surrounding the comparison transaction, such as its size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, the timeliness of the information, and, with respect to the final factor listed in paragraph (b)(6), [above,]the relative spread of the quotations in the similar security to the quotations in the subject security.

(8) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, NASD or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (*e.g.*, discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (*e.g.*, coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(9) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of “similar” securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in “similar” securities taken as a whole.

(c) “Similar” securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the

"similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar," as that term is used in this [Interpretation]IM-2440-2, to the subject security may be determined by factors that include but are not limited to the following:[];

(A[a]) Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (*e.g.*, changes to ratings outlooks));

(B[b]) The extent to which the spread (*i.e.*, the spread over U.S. Treasury securities of a similar duration) at which the "similar" security trades is comparable to the spread at which the subject security trades;

(C[c]) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and

(D[d]) Technical factors such as the size of the issue, the float and

recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

^{1.} The Interpretation does not apply to transactions in municipal securities. Single terms in parentheses within sentences, such as the terms “(sales)” and “(to)” in the phrase, “contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts,” refer to scenarios where a member is charging a customer a mark-down.

EXHIBIT 5

Proposed Rule Text

IM-2440-1. Mark-Up Policy

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IM-2440-2. Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities¹

(a) Scope

IM-2440-1 applies to debt securities transactions, and this IM-2440-2 supplements the guidance provided in IM-2440-1.

(b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this IM-2440-2, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with NASD pricing rules. (See, e.g., Rule 2320).

(2) When the dealer is *selling* the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous purchases* in the security or can show that in the particular circumstances the dealer's *contemporaneous cost* is not indicative of the prevailing market price. When the dealer is *buying* the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous sales* in the security

or can show that in the particular circumstances the dealer's contemporaneous proceeds are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost or proceeds must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost or proceeds are not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates or the credit quality of the security changed significantly, or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) because the size of such transaction, either large or small, caused the transaction to be executed at a price away from the prevailing market price of the same security, as evidenced by contemporaneous

transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities.

(5) In instances where the dealer has established that the dealer's cost (proceeds) are no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price, such as (i) where interest rates or the credit quality of the security changed significantly, or news issued or otherwise distributed and known to the marketplace had an effect on the perceived value of the debt security, after the dealer's contemporaneous transaction, or (ii) the size of the transaction, either large or small, caused the transaction to be executed away from the prevailing market price, the most important or first pricing factor that should be taken into consideration in establishing prevailing market price for a mark-up or a mark-down is prices of any contemporaneous inter-dealer transactions in the security in question. In the absence of inter-dealer transactions, the second factor that should be taken into consideration in establishing the prevailing market prices for mark-ups (mark-downs) to customers is prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security. For actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations, may be used in the absence of inter-dealer or

institutional transactions (described in the preceding sentence) in determining prevailing market price for customer mark-ups (mark-downs).

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a “similar” security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a “similar” security with institutional accounts with which any dealer regularly effects transactions in the “similar” security with respect to customer mark-ups (mark-downs);
- Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;
- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

(7) The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the transaction prices, quotes and yields described in the three factors in paragraph (b)(5) and the four factors in

paragraph (b)(6) depends on the facts and circumstances surrounding the comparison transaction, such as its size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, the timeliness of the information, and, with respect to the final factor listed in paragraph (b)(6), the relative spread of the quotations in the similar security to the quotations in the subject security.

(8) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, NASD or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (e.g., discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(9) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of “similar” securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in “similar” securities taken as a whole.

(c) "Similar" securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar," as that term is used in this IM-2440-2, to the subject security may be determined by factors that include but are not limited to the following:

(A) Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (e.g., changes to ratings outlooks));

(B) The extent to which the spread (i.e., the spread over U.S. Treasury securities of a similar duration) at which the "similar" security trades is comparable to the spread at which the subject security trades;

(C) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the

structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and

(D) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

^{1.} The Interpretation does not apply to transactions in municipal securities. Single terms in parentheses within sentences, such as the terms “(sales)” and “(to)” in the phrase, “contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts,” refer to scenarios where a member is charging a customer a mark-down.