

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"/>		
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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="11/22/2005"/>
By	<input type="text" value="Patrice Gliniecki"/>
	(Name)
	<input type="text" value="Senior Vice President and Deputy General Counsel"/>
	(Title)

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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.

On September 16, 2003, NASD filed SR-NASD-2003-141 with the Securities and Exchange Commission (“Commission” or “SEC”) to propose a second interpretation, proposed IM-2440-2, “Additional Mark-Up Policy for Transactions in Debt Securities” (“Proposed Interpretation”), to Rule 2440. The Proposed Interpretation provides additional mark-up guidance for transactions in debt securities, except municipal securities. Amendment No. 1 and Amendment No. 2 to SR-NASD-2003-141 were filed, respectively, on June 29, 2004 and February 17, 2005. The proposed rule change was published for notice and comment on March 15, 2005.¹ NASD’s response to comments was filed on October 4, 2005, and Amendment No. 3 was filed on October 11, 2005.

Based upon comments from the SEC staff, NASD is filing this partial amendment to the proposed rule change as discussed in detail below, with the relevant excerpts of the amended Proposed Interpretation text set forth in attached Exhibit A (below) marked to show changes from Amendment No. 3. NASD is also including with this partial amendment Exhibit 4 (below), which is the full text of the Proposed Interpretation marked to show changes from Amendment No. 3. NASD is also including Exhibit 5 (below), which is the full text of the Proposed Interpretation marked to show changes from the version of the Proposed Interpretation that was published in the Federal Register.

Proposed Rule Changes.

NASD is proposing amendments to paragraphs (b)(5) through (b)(9) of the Proposed Interpretation to clarify an amendment proposed in Amendment No. 3 to paragraph (b)(7) relating to paragraph (b)(5), and to renumber paragraphs in part (b) of the Proposed Interpretation.

Paragraph (b)(5).

NASD proposes to revise paragraph (b)(5) of the Proposed Interpretation to clarify further that a dealer is required to look to the three categories of information -- inter-dealer transactions, certain dealer-institutional transactions (described therein), and certain quotations (as described therein) -- *in the order listed* to identify prevailing market price. NASD also proposes to clarify how the language that NASD added in Amendment No. 3 to paragraph (b)(7) (and now proposes to relocate to paragraph (b)(5)) applies to a dealer’s process for identifying the prevailing market price under that paragraph. See attached Exhibit A to Partial Amendment No. 4 for the revisions proposed to paragraph (b)(5) and (b)(6), including the relocation of text from (b)(7) to the end of paragraph (b)(6). See also attached Exhibit 4 for the proposed revised Proposed Interpretation, marked to show changes from Amendment No. 3.

¹ See Securities Exchange Act Release No. 51338 (March 9, 2005), 70 FR 12764 (March 15, 2005) (notice of filing of and request for comments on SR-NASD-2003-141, which included proposed amendments contained in Amendment No. 1 and Amendment No. 2 to SR-NASD-2003-141).

Paragraph (b)(5) establishes a hierarchy of three types of pricing information — inter-dealer transactions, certain dealer-institutional transactions, and certain quotations -- which a dealer must review in the prescribed order to establish prevailing market price when the dealer has no contemporaneous cost or has presented evidence that is sufficient to overcome the presumption that the dealer’s contemporaneous cost or proceeds provide the best measure of prevailing market price.

Reviewing Paragraph (b)(5) Information In Required Order. The proposed amendments to paragraph (b)(5) state more clearly that a dealer is required to look to the three categories of information in the order listed. Thus, a dealer is required to consider pricing information from the first category of information -- any contemporaneous inter-dealer transactions -- and identify prevailing market price exclusively from that pricing information, if such information exists, subject to certain exceptions. As a general principle, a dealer is permitted to look to the second category of information – certain dealer-institutional trades -- only if there are no inter-dealer trades. Similarly, a dealer is permitted to look to the third category of information, certain qualified quotations, only if there are no inter-dealer trades *or* dealer-institutional trades.

Size and Other Exceptions. The additional portion of the amended text of proposed paragraph (b)(5) describes the limited exception to the general principles set forth above. As previously incorporated in the Proposed Interpretation (in former paragraph (b)(7)), NASD recognized that when looking to comparable transactions and quotations for prevailing market price information, the relative weight that a dealer may attribute to such information “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 . . .” To the extent applicable, NASD simply has made clear, in proposed paragraph (b)(5), that size, side of market, and timeliness of information may also affect the quality of prevailing market price information that a dealer may derive from the three ordered factors in proposed paragraph (b)(5) -- inter-dealer transactions, certain dealer-institutional transactions, and certain qualified quotations.

The limited exception works as follows. When a dealer looks to contemporaneous inter-dealer transactions and identifies more than one such transaction, among other things, the dealer might weigh the comparability of the transactions overall, or might look to the most recent of the multiple contemporaneous transactions in the dealer’s good faith effort to identify prevailing market price. However, if the dealer’s transaction (the subject transaction) is for 10 bonds and the inter-dealer transaction is (or transactions are) for 200 bonds (the comparison transactions), under the size exception to the general principle, the dealer may determine that the contemporaneous inter-dealer transactions should not be used as the prevailing market price for the subject transaction because the size(s) of the comparison transactions are so dissimilar to the size of the subject transaction that the dealer believes that use of such price does not accurately identify prevailing market price. In this case, the dealer is permitted to disregard the transaction (or transactions) and look exclusively to the second category of information,

certain dealer-institutional transactions. During the exclusive review of the comparison dealer-institutional transactions, a dealer-institutional transaction also may be rejected based on size. If a dealer is required to resort to a review of the third category of pricing information -- certain qualified quotations -- these comparison quotations also may be disregarded on the basis of size; in addition, quotations may be disregarded if they are not on the same side of the market as the dealer in the subject transaction.

Other Changes.

NASD also proposes to relocate the text of proposed paragraph (b)(7) to the end of proposed paragraph (b)(6) and to make minor, conforming changes to the text. Finally, NASD proposes to renumber proposed paragraphs (b)(8) and (b)(9) as proposed paragraphs (b)(7) and (b)(8).

* * * * *

Exhibit A to Partial Amendment No. 4

1. NASD proposes to revise paragraph (b)(5) of the Proposed Interpretation as follows:

(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, a member must consider, in the order listed, the following types of pricing information to determine 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.]

(A) Prices of any contemporaneous inter-dealer transactions in the security in question;

(B) In the absence of transactions described in (A), 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; or[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.]

(C) In the absence of transactions described in (A) and (B), 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.[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).]

In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (i.e., either a particular transaction price, or, in (C) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (i.e., such as size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, and timeliness of the information). As an initial matter, a dealer is required to look exclusively to all contemporaneous inter-dealer transactions to identify prevailing market price, provided, however, that a dealer may consider and reject any contemporaneous inter-dealer transaction if the size of such transaction, either large or small, is so dissimilar to the size of the subject transaction that a dealer can demonstrate that such transactions fail to identify the prevailing market price. If only one contemporaneous inter-dealer transaction exists and the dealer rejects the transaction based on size differences (or if multiple such transactions exist and are rejected based on size differences), the dealer then may consider exclusively the second type of pricing information, the contemporaneous dealer-institutional transactions described in (B) above, to establish prevailing market price. In reviewing transactions described in (B) above, or, thereafter, if necessary, quotations described in (C) above, a dealer is permitted to disregard transaction or quotation information due to the size differences between the comparison transaction or quotation and the subject transaction, and with respect to quotations, if the comparison quotations are not for the same side of the market as the dealer's position in the subject transaction.

2. NASD proposes to amend the text of proposed paragraph (b)(7), and incorporate it in proposed paragraph (b)(6). Paragraph (b)(6) would read as follows:

(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).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (i.e., size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

[(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.]

3. NASD proposes to renumber proposed paragraphs (b)(8) and (b)(9) as paragraphs (b)(7) and (b)(8).

EXHIBIT 4

Changes to Proposed Interpretation Text from Amendment No. 3 to Amendment No. 4.

Proposed new language is underlined, and 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, a member must consider, in the order listed, the following types of pricing information to determine 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.]

(A) Prices of any contemporaneous inter-dealer transactions in the security in question;

(B) In the absence of transactions described in (A), 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; or[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.]

(C) In the absence of transactions described in (A) and (B), 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.[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).]

In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (i.e., either a particular transaction price, or, in (C) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (i.e., such as size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, and timeliness of the information). As an initial matter, a dealer is required to look exclusively to all contemporaneous inter-dealer transactions to identify prevailing market price, provided, however, that a dealer may consider and reject any

contemporaneous inter-dealer transaction if the size of such transaction, either large or small, is so dissimilar to the size of the subject transaction that a dealer can demonstrate that such transactions fail to identify the prevailing market price. If only one contemporaneous inter-dealer transaction exists and the dealer rejects the transaction based on size differences (or if multiple such transactions exist and are rejected based on size differences), the dealer then may consider exclusively the second type of pricing information, the contemporaneous dealer-institutional transactions described in (B) above, to establish prevailing market price. In reviewing transactions described in (B) above, or, thereafter, if necessary, quotations described in (C) above, a dealer is permitted to disregard transaction or quotation information due to the size differences between the comparison transaction or quotation and the subject transaction, and with respect to quotations, if the comparison quotations are not for the same side of the market as the dealer's position in the subject transaction.

(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).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (i.e., size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

[(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.]

(7[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.

(8[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.

EXHIBIT 5

Proposed Interpretation Text Marked to Show Amendment No. 3 and Amendment No. 4 Changes Compared to Proposed Interpretation Text Through Amendment No. 2 to SR-NASD-2003-141 (i.e., compared to Proposed Interpretation text as published in the Federal Register).

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 [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, a member must consider, in the order listed, the following types of pricing information to determine 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.]

(A) Prices of any contemporaneous inter-dealer transactions in the security in question;

(B) In the absence of transactions described in (A), 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; or [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.]

(C) In the absence of transactions described in (A) and (B), 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. [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).]

In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (i.e., either a particular transaction price, or, in (C) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (i.e., such as size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, and timeliness of the information). As an initial matter, a dealer is required to look exclusively to all contemporaneous inter-dealer transactions to identify prevailing market price, provided, however, that a dealer may consider and reject any contemporaneous inter-dealer transaction if the size of such transaction, either large or small, is so dissimilar to the size of the subject transaction that a dealer can demonstrate that such transactions fail to identify the prevailing market price. If only one contemporaneous inter-dealer transaction exists and the dealer rejects the transaction based on size differences (or if multiple such transactions exist and are rejected based on size differences), the dealer then may consider exclusively the second type of pricing information, the contemporaneous dealer-institutional transactions described in (B) above, to establish prevailing market price. In

reviewing transactions described in (B) above, or, thereafter, if necessary, quotations described in (C) above, a dealer is permitted to disregard transaction or quotation information due to the size differences between the comparison transaction or quotation and the subject transaction, and with respect to quotations, if the comparison quotations are not for the same side of the market as the dealer's position in the subject transaction.

(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).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (i.e., size, whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

[(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.]

(7)[(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.

(8)[(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.

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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.