

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="Andrea"/>	Last Name	<input type="text" value="Orr"/>
Title	<input type="text" value="Assistant General Counsel"/>		
E-mail	<input type="text" value="andrea.orr@nasd.com"/>		
Telephone	<input type="text" value="(202) 728-8156"/>	Fax	<input type="text" value="(202) 728-8264"/>

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="09/13/2005"/>
By	<input type="text" value="Stephanie Dumont"/>
	(Name)
	<input type="text" value="Vice President and Associate 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. 4 to SR-NASD-2004-135, a proposed rule change to adopt NASD Rule 2441, which would require disclosure and consent when trading on a net basis with customers. The purpose of this Amendment No. 4 is to address the comment letters received by the Commission in response to the publication in the Federal Register of Notice of Filing of File No. SR-NASD-2004-135 and to propose amendments responsive to the comments where appropriate.¹

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

2441. Net Transactions with Customers

(a) Prior to executing a transaction for or with a customer on a “net” basis as defined in paragraph (e) below, a member must provide disclosure to and obtain consent from the customer as provided in this Rule.

(b) With respect to non-institutional customers, the member must obtain the customer’s written consent on an order-by-order basis prior to executing a transaction for or with the customer on a “net” basis and such consent must evidence the customer’s understanding of the terms and conditions of the order.

¹ See Exchange Act Release No. 51457 (March 31, 2005), 70 FR 17489 (April 6, 2005).

(c) With respect to institutional customers, a member must obtain the customer's consent prior to executing a transaction for or with the customer on a "net" basis in accordance with one of the following methods:

(1) a negative consent letter that clearly discloses to the institutional customer in writing the terms and conditions for handling the customer order(s) and provides the institutional customer with a meaningful opportunity to object to the execution of transactions on a net basis. If the customer does not object, then the member may reasonably conclude that the institutional customer has consented to the member trading on a "net" basis with the customer and the member may rely on such letter for all or a portion of the customer's orders (as instructed by the customer) pursuant to this Rule;

(2) oral disclosure to and consent from the customer on an order-by-order basis. Such oral disclosure and consent must clearly explain the terms and conditions for handling the customer order and provide the institutional customer with a meaningful opportunity to object to the execution of the transaction on a net basis. The member also must document, on an order-by-order basis, the customer's understanding of the terms and conditions of the order and the customer's consent; or

(3) written consent on an order-by-order basis prior to executing a transaction for or with the customer on a "net" basis and such consent must evidence the customer's understanding of the terms and conditions of the order.

(d) For those customers that have granted trading discretion to a fiduciary (e.g. an investment adviser), a member is permitted to obtain the consent required under this Rule

from the fiduciary. If the fiduciary meets the definition of “institutional customer” in paragraph (e), the member may meet the disclosure and consent requirements under this Rule in the same manner permitted for institutional customers.

(e) For purposes of this Rule, (1) “institutional customer” shall mean a customer whose account qualifies as an “institutional account” under Rule 3110(c)(4); and (2) “net” transaction shall mean a principal transaction in which a market maker, after having received an order to buy (sell) an equity security, purchases (sells) the equity security at one price (from (to) another broker-dealer or another customer) and then sells to (buys from) the customer at a different price.

(f) Members must retain and preserve all documentation relating to consent obtained pursuant to this Rule in accordance with Rule 3110(a).

* * * * *

(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 21, 2004, 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 NASD Board of Governors had an opportunity to review the proposed rule at its meeting on July 22, 2004. 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 NASD Board of Governors 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

Rule Filing History

On September 1, 2004, NASD filed with the Commission proposed rule change SR-NASD-2004-135, proposing the adoption of NASD Rule 2441 (the “original filing”), which would clarify and codify the staff position that market makers that intend to trade on a net basis with their customers are required to provide disclosure to, and obtain consent from, the customer. On February 16, 2005, NASD filed with the Commission Amendment No. 1 to SR-NASD-2004-135 (“Amendment No. 1”), which proposed to make certain deletions to the rule text and other conforming changes therein. On February 25, 2005, NASD filed with the Commission Amendment No. 2 to SR-NASD-2004-135 (“Amendment No. 2”), which proposed a technical correction to the rule filing. On March 21, 2005, NASD filed with the Commission Amendment No. 3 to SR-NASD-2004-135 (“Amendment No. 3”), which proposed to make certain clarifying changes to rule text. On April 6, 2005, the Commission published for comment the proposed rule change in the Federal Register. Based on comments received in response to the publication of the proposed rule change in the Federal Register, NASD is filing this

Amendment No. 4 to SR-NASD-2004-135 (“Amendment No. 4”) to make certain changes as described herein.

Proposal

As described in the original filing, NASD is proposing to clarify and codify NASD staff’s position that a member is required to provide disclosure to, and obtain consent from a customer prior to executing a transaction with a customer on a “net” basis. As described in the original rule filing, with respect to non-institutional customers,² the member must obtain the customer’s written consent on an order-by-order basis prior to executing a transaction for or with the customer on a “net” basis and such consent must evidence the customer’s understanding of the terms and conditions of the order. With respect to institutional customers, a member also must obtain consent, but it may be evidenced through the use of a negative consent letter.³

Comments to the Proposed Rule Change

The Commission received three comment letters in response to the publication of the proposed rule change in the Federal Register.⁴ The commenters raised several issues relating to the proposed rule change, which are summarized below.

² For purposes of the proposed rule, “institutional customer” shall mean a customer that qualifies as an “institutional account” under Rule 3110(c)(4). A non-institutional customer, therefore, would be an account for a customer that does not qualify as an institutional account under Rule 3110(c)(4).

³ As part of this proposed rule change, NASD also is proposing a technical change to the rule text to make clear that the negative consent may apply to all or only a portion of the customer's orders, if the customer instructs the firm accordingly.

⁴ Comments were submitted by the following: The Seidler Companies Inc. and the Self-Regulation and Supervisory Practices and Trading Committee of the Securities Industry Association (SIA). The SEC also received an email correspondence from David Sieradzki regarding a phone conversation with SEC staff, which is part of the official

Comments Relating to Net Transactions with Institutional Customers

Two of the commenters asserted that the proposed disclosure and consent requirements were unnecessary with respect to institutional customers, given that members and their customers generally agree on the terms at the time the order is placed and that such orders generally are initiated by sophisticated customers. One of the commenters, although opposing the proposal in its entirety, offered an alternative approach that would provide members with the option of using oral consent on an order-by-order basis for institutional accounts. This commenter also suggested that members choosing to use this method to comply with the requirements should be permitted to use a one-time disclosure statement to meet the pre-trade disclosure requirements.

NASD believes that, for purposes of institutional customers, an oral, order-by-order disclosure and consent requirement would meet the objectives of the proposed rule. Accordingly, in response to the comments received, NASD is proposing to amend the proposed rule change to provide members the option of obtaining consent from institutional customers orally, on an order-by-order basis.

However, NASD does not believe that, under such circumstances, a one-time disclosure would be appropriate. Rather, NASD is proposing that members that choose to obtain consent orally on an order-by-order basis also must clearly explain to the institutional customer, prior to each transaction, the terms and conditions for the handling

record of this filing. In this email correspondence, Mr. Sieradzki indicated that there may be an inconsistency between net trading and Rule 4632(d)(3)(A), which generally provides that, for principal transactions, the reporting member must report separately each purchase and sale transaction and not include any mark-up, mark-down or service charge. NASD notes that the trade reporting requirements relating to net trades are not germane to this proposed rule change and does not believe any changes to those requirements are necessary at this time.

of the order and provide the institutional customer with a meaningful opportunity to object to the execution of the transaction on a net basis. Members also must document, on an order-by-order basis, the customer's understanding of the terms and conditions of the order and the customer's consent. As with other forms of consent obtained under the proposed rule, members would be required to retain and preserve all documentation relating to the verbal consent obtained.

Comments Relating to Net Transactions With Non-Institutional Customers

One of the commenters opposed the consent and disclosure requirements for non-institutional customer arguing that they are confusing, costly, impossible to manage and track on an order-by-order basis and will result in delays and loss of business. This commenter also stated that information regarding "bids" and "asks" is readily available, such that a customer can easily determine the spread on a trade. Further, customers can always request detailed information regarding their trades from the member.

Another commenter also opposed the proposed consent and disclosure requirements for non-institutional customers, indicating that they are onerous and impractical and noted the general decline in net trading. This commenter suggested an alternative approach that would provide members with the option of using negative consent letters or obtaining verbal consent on an order-by-order basis for non-institutional customers.

While NASD recognizes the burdens that result from having to obtain written consent on an order-by-order basis, NASD believes that the proposed written disclosure and consent requirements are critical to ensuring that important information regarding members' methods of compensation on a transaction is provided to non-institutional

customers and that the non-institutional customers affirmatively agree to such compensation structure, particularly in instances where the non-institutional customer may be trading net and also paying an explicit commission. Although NASD agrees that there is an increasing amount of market information available to customers, NASD does not believe that such information will assist a customer in determining whether a member is trading “net” and understanding the ramifications of trading “net.” NASD believes that the benefits to non-institutional customers provided by requiring member disclosure and consent clearly outweigh the related costs and burdens to members. While NASD has allowed negative consent when trading on a net basis with institutional customers, NASD does not believe negative consent is appropriate with respect to non-institutional customers.

One commenter suggested that, in the case of a fiduciary granted trading discretion of a non-institutional customer account that, on its own, qualifies as an institutional account under the proposed rule, the member should be permitted to obtain consent from the fiduciary in the same manner as permitted for institutional customers. NASD agrees with the commenter that, absent instructions to the contrary, a member may look to the institutional or non-institutional status of the fiduciary, rather than the underlying account, when determining which method of disclosure and consent is permitted under the proposed rule change. NASD is proposing to amend the proposed rule change accordingly.

Requests for Clarifications

One of the commenters requested clarification as to whether the proposed consent and disclosure requirements apply to orders received from members and other registered

broker-dealers. In addition, the commenter requested clarification that a receiving broker-dealer handling an order marked “net” routed to it from an originating broker-dealer would not have consent and disclosure obligations to the customer of the originating broker-dealer. NASD is clarifying that the proposed rule change does not apply to orders received from member firms and other registered broker-dealers. Accordingly, the proposed rule change would not apply to the receiving broker-dealer in either of the scenarios noted by the commenter, consistent with the application of customer confirmation requirements under SEC Rule 10b-10. Rather, the originating broker-dealer would be responsible for meeting the proposed requirements. NASD notes, however, that the receiving broker-dealer may have other obligations to that order pursuant to other NASD or SEC rules.

(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's 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 the proposed rule will promote investor protection by codifying the requirement that members provide disclosure and obtain customer consent when trading on a net basis.

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

Written comments on the proposed rule change were solicited by the Commission in response to SR-NASD-2004-135, which proposed to require disclosure and consent when trading on a net basis with customers. The Commission received three comment letters in response to the Federal Register publication of SR-NASD-2004-135.⁵ The comments are summarized above.

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 the proposed rule change prior to the 30th day after its publication in the Federal Register.

Because NASD believes the proposed rule change will clarify and codify the disclosure and consent requirements when trading on a net basis, NASD requests the Commission to accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the Federal Register.

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

Not applicable.

⁵ See supra note 3.

9. Exhibits

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

Exhibit 4. Exhibit 4 shows the full text of rule change marking changes from the original filing including all amendments thereto, with the original filing and all amendments thereto changes shown as if adopted, and the new language in this Amendment No. 4 marked to show additions and deletions.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2004-135)
SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Association of Securities Dealers, Inc.
Relating to the Adoption of NASD Rule 2441 to Require Disclosure and Consent When
Trading on a Net Basis With Customers

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 , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) Amendment No. 4 to the proposed rule change³ 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On September 1, 2004, NASD filed with the Commission proposed rule change SR-NASD-2004-135, proposing the adoption of Rule 2441. On February 16, 2005, NASD filed with the Commission Amendment No. 1 to SR-NASD-2004-135, which proposed certain deletions to the rule text and other conforming changes therein. On February 25, 2005, NASD filed with the Commission Amendment No. 2 to SR-NASD-2004-135, which proposed a technical correction to the rule filing. On March 21, 2005, NASD filed with the Commission Amendment No. 3 to SR-NASD-2004-135, which proposed certain clarifying changes to rule text.

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

NASD is proposing to adopt NASD Rule 2441, which would require disclosure and consent when trading on a net basis with customers. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

2441. Net Transactions with Customers

(a) Prior to executing a transaction for or with a customer on a "net" basis as defined in paragraph (e) below, a member must provide disclosure to and obtain consent from the customer as provided in this Rule.

(b) With respect to non-institutional customers, the member must obtain the customer's written consent on an order-by-order basis prior to executing a transaction for or with the customer on a "net" basis and such consent must evidence the customer's understanding of the terms and conditions of the order.

(c) With respect to institutional customers, a member must obtain the customer's consent prior to executing a transaction for or with the customer on a "net" basis in accordance with one of the following methods:

(1) a negative consent letter that clearly discloses to the institutional customer in writing the terms and conditions for handling the customer order(s) and provides the institutional customer with a meaningful opportunity to object to the execution of transactions on a net basis. If the customer does not object, then the member may reasonably conclude that the institutional customer has consented to the member trading on a "net" basis with the customer and the

member may rely on such letter for all or a portion of the customer's orders (as instructed by the customer) pursuant to this Rule;

(2) oral disclosure to and consent from the customer on an order-by-order basis. Such oral disclosure and consent must clearly explain the terms and conditions for handling the customer order and provide the institutional customer with a meaningful opportunity to object to the execution of the transaction on a net basis. The member also must document, on an order-by-order basis, the customer's understanding of the terms and conditions of the order and the customer's consent; or

(3) written consent on an order-by-order basis prior to executing a transaction for or with the customer on a "net" basis and such consent must evidence the customer's understanding of the terms and conditions of the order.

(d) For those customers that have granted trading discretion to a fiduciary (e.g. an investment adviser), a member is permitted to obtain the consent required under this Rule from the fiduciary. If the fiduciary meets the definition of "institutional customer" in paragraph (e), the member may meet the disclosure and consent requirements under this Rule in the same manner permitted for institutional customers.

(e) For purposes of this Rule, (1) "institutional customer" shall mean a customer whose account qualifies as an "institutional account" under Rule 3110(c)(4); and (2) "net" transaction shall mean a principal transaction in which a market maker, after having received an order to buy (sell) an equity security, purchases (sells) the equity security at one price (from (to) another broker-dealer or another customer) and then sells to (buys from) the customer at a different price.

(f) Members must retain and preserve all documentation relating to consent obtained pursuant to this Rule in accordance with Rule 3110(a).

* * * * *

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

Rule Filing History

On September 1, 2004, NASD filed with the Commission proposed rule change SR-NASD-2004-135, proposing the adoption of NASD Rule 2441 (the "original filing"), which would clarify and codify the staff position that market makers that intend to trade on a net basis with their customers are required to provide disclosure to, and obtain consent from, the customer. On February 16, 2005, NASD filed with the Commission Amendment No. 1 to SR-NASD-2004-135 ("Amendment No. 1"), which proposed to make certain deletions to the rule text and other conforming changes therein. On February 25, 2005, NASD filed with the Commission Amendment No. 2 to SR-NASD-2004-135 ("Amendment No. 2"), which proposed a technical correction to the rule filing. On March 21, 2005, NASD filed with the Commission Amendment No. 3 to SR-NASD-

2004-135 (“Amendment No. 3”), which proposed to make certain clarifying changes to rule text. On April 6, 2005, the Commission published for comment the proposed rule change in the Federal Register. Based on comments received in response to the publication of the proposed rule change in the Federal Register, NASD is filing this Amendment No. 4 to SR-NASD-2004-135 (“Amendment No. 4”) to make certain changes as described herein.

Proposal

As described in the original filing, NASD is proposing to clarify and codify NASD staff’s position that a member is required to provide disclosure to, and obtain consent from a customer prior to executing a transaction with a customer on a “net” basis. As described in the original rule filing, with respect to non-institutional customers,⁴ the member must obtain the customer’s written consent on an order-by-order basis prior to executing a transaction for or with the customer on a “net” basis and such consent must evidence the customer’s understanding of the terms and conditions of the order. With respect to institutional customers, a member also must obtain consent, but it may be evidenced through the use of a negative consent letter.⁵

⁴ For purposes of the proposed rule, “institutional customer” shall mean a customer that qualifies as an “institutional account” under Rule 3110(c)(4). A non-institutional customer, therefore, would be an account for a customer that does not qualify as an institutional account under Rule 3110(c)(4).

⁵ As part of this proposed rule change, NASD also is proposing a technical change to the rule text to make clear that the negative consent may apply to all or only a portion of the customer's orders, if the customer instructs the firm accordingly.

Comments to the Proposed Rule Change

The Commission received three comment letters in response to the publication of the proposed rule change in the Federal Register.⁶ The commenters raised several issues relating to the proposed rule change, which are summarized below.

Comments Relating to Net Transactions with Institutional Customers

Two of the commenters asserted that the proposed disclosure and consent requirements were unnecessary with respect to institutional customers, given that members and their customers generally agree on the terms at the time the order is placed and that such orders generally are initiated by sophisticated customers. One of the commenters, although opposing the proposal in its entirety, offered an alternative approach that would provide members with the option of using oral consent on an order-by-order basis for institutional accounts. This commenter also suggested that members choosing to use this method to comply with the requirements should be permitted to use a one-time disclosure statement to meet the pre-trade disclosure requirements.

NASD believes that, for purposes of institutional customers, an oral, order-by-order disclosure and consent requirement would meet the objectives of the proposed rule. Accordingly, in response to the comments received, NASD is proposing to amend the

⁶ Comments were submitted by the following: The Seidler Companies Inc. and the Self-Regulation and Supervisory Practices and Trading Committee of the Securities Industry Association (SIA). The SEC also received an email correspondence from David Sieradzki regarding a phone conversation with SEC staff, which is part of the official record of this filing. In this email correspondence, Mr. Sieradzki indicated that there may be an inconsistency between net trading and Rule 4632(d)(3)(A), which generally provides that, for principal transactions, the reporting member must report separately each purchase and sale transaction and not include any mark-up, mark-down or service charge. NASD notes that the trade reporting requirements relating to net trades are not germane to this proposed rule change and does not believe any changes to those requirements are necessary at this time.

proposed rule change to provide members the option of obtaining consent from institutional customers orally, on an order-by-order basis.

However, NASD does not believe that, under such circumstances, a one-time disclosure would be appropriate. Rather, NASD is proposing that members that choose to obtain consent orally on an order-by-order basis also must clearly explain to the institutional customer, prior to each transaction, the terms and conditions for the handling of the order and provide the institutional customer with a meaningful opportunity to object to the execution of the transaction on a net basis. Members also must document, on an order-by-order basis, the customer's understanding of the terms and conditions of the order and the customer's consent. As with other forms of consent obtained under the proposed rule, members would be required to retain and preserve all documentation relating to the verbal consent obtained.

Comments Relating to Net Transactions With Non-Institutional Customers

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Another commenter also opposed the proposed consent and disclosure requirements for non-institutional customers, indicating that they are onerous and impractical and noted the general decline in net trading. This commenter suggested an alternative approach that would provide members with the option of using negative

consent letters or obtaining verbal consent on an order-by-order basis for non-institutional customers.

While NASD recognizes the burdens that result from having to obtain written consent on an order-by-order basis, NASD believes that the proposed written disclosure and consent requirements are critical to ensuring that important information regarding members' methods of compensation on a transaction is provided to non-institutional customers and that the non-institutional customers affirmatively agree to such compensation structure, particularly in instances where the non-institutional customer may be trading net and also paying an explicit commission. Although NASD agrees that there is an increasing amount of market information available to customers, NASD does not believe that such information will assist a customer in determining whether a member is trading "net" and understanding the ramifications of trading "net." NASD believes that the benefits to non-institutional customers provided by requiring member disclosure and consent clearly outweigh the related costs and burdens to members. While NASD has allowed negative consent when trading on a net basis with institutional customers, NASD does not believe negative consent is appropriate with respect to non-institutional customers.

One commenter suggested that, in the case of a fiduciary granted trading discretion of a non-institutional customer account that, on its own, qualifies as an institutional account under the proposed rule, the member should be permitted to obtain consent from the fiduciary in the same manner as permitted for institutional customers. NASD agrees with the commenter that, absent instructions to the contrary, a member may look to the institutional or non-institutional status of the fiduciary, rather than the

underlying account, when determining which method of disclosure and consent is permitted under the proposed rule change. NASD is proposing to amend the proposed rule change accordingly.

Requests for Clarifications

One of the commenters requested clarification as to whether the proposed consent and disclosure requirements apply to orders received from members and other registered broker-dealers. In addition, the commenter requested clarification that a receiving broker-dealer handling an order marked “net” routed to it from an originating broker-dealer would not have consent and disclosure obligations to the customer of the originating broker-dealer. NASD is clarifying that the proposed rule change does not apply to orders received from member firms and other registered broker-dealers. Accordingly, the proposed rule change would not apply to the receiving broker-dealer in either of the scenarios noted by the commenter, consistent with the application of customer confirmation requirements under SEC Rule 10b-10. Rather, the originating broker-dealer would be responsible for meeting the proposed requirements. NASD notes, however, that the receiving broker-dealer may have other obligations to that order pursuant to other NASD or SEC rules.

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's 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 the proposed rule will promote investor protection by

codifying the requirement that members provide disclosure and obtain customer consent when trading on a net basis.

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

Written comments on the proposed rule change were solicited by the Commission in response to SR-NASD-2004-135, which proposed to require disclosure and consent when trading on a net basis with customers. The Commission received three comment letters in response to the Federal Register publication of SR-NASD-2004-135.⁷ The comments are summarized above.

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

⁷ See supra note 3.

filing thereof in that accelerated approval will clarify and codify the disclosure and consent requirements when trading on a net basis.

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-2004-135 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-135. 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-2004-135 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.⁸

Secretary

⁸ 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Exhibit 4 shows the full text of rule change marking changes from SR-NASD-2004-135, including Amendments No. 1, 2 and 3, to this Amendment No. 4, with the language in SR-NASD-2004-135, together with Amendments No. 1, 2 and 3 shown as if adopted, and the new language in this Amendment No. 4 marked to show additions and deletions.

Proposed new language is underlined
Proposed deletions are in brackets

* * * *

2441. Net Transactions with Customers

(a) Prior to executing a transaction for or with a customer on a “net” basis as defined in paragraph [(d)](e) below, a member must provide disclosure to and obtain consent from the customer as provided in this Rule.

(b) With respect to non-institutional customers, the member must obtain the customer’s written consent on an order-by-order basis prior to executing a transaction for or with the customer on a “net” basis and such consent must evidence the customer’s understanding of the terms and conditions of the order. [For those non-institutional customers that have granted trading discretion to a fiduciary (e.g. an investment adviser), a member is permitted to obtain such consent from the fiduciary.]

(c) With respect to institutional customers, a member [may] must obtain the customer’s consent [through the use of a negative consent letter] prior to executing a transaction for or with the customer on a “net” basis [. If evidencing the consent of an institutional customer through the use of a negative consent letter, before obtaining such consent, a member] in accordance with one of the following methods:

(1) a negative consent letter that [must] clearly discloses to the institutional customer in writing the terms and conditions for handling the

customer order(s) and provides the institutional customer with a meaningful opportunity to object to the execution of transactions on a net basis. If the customer does not object[no objection from the customer is received], then the member may reasonably conclude that the institutional customer has consented to the member trading on a “net” basis with the customer and the member may rely on such letter for all or a portion of the customer’s orders (as[unless] instructed by the customer[otherwise]) pursuant to this Rule.

(2) oral disclosure to and consent from the customer on an order-by-order basis. Such oral disclosure and consent must clearly explain the terms and conditions for handling the customer order and provide the institutional customer with a meaningful opportunity to object to the execution of the transaction on a net basis. The member also must document, on an order-by-order basis, the customer’s understanding of the terms and conditions of the order and the customer’s consent; or

(3) written consent on an order-by-order basis prior to executing a transaction for or with the customer on a “net” basis and such consent must evidence the customer’s understanding of the terms and conditions of the order.

(d) For those customers that have granted trading discretion to a fiduciary (e.g. an investment adviser), a member is permitted to obtain the consent required under this Rule from the fiduciary. If the fiduciary meets the definition of “institutional customer” in paragraph (e), the member may meet the disclosure and consent requirements under this Rule in the same manner permitted for institutional customers.

(e) For purposes of this Rule, (1) “institutional customer” shall mean a customer whose account qualifies as an “institutional account” under Rule 3110(c)(4); and (2) “net” transaction shall mean a principal transaction in which a market maker, after having received an order to buy (sell) an equity security, purchases (sells) the equity security at one price (from (to) another broker-dealer or another customer) and then sells to (buys from) the customer at a different price.

(f)~~(e)~~ Members must retain and preserve all documentation relating to consent obtained pursuant to this Rule in accordance with Rule 3110(a).