

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

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

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

Proposed amendments to expand NASD's current Order Audit Trail System (OATS) exemptive authority to include recording requirements.

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 Last Name
 Title
 E-mail
 Telephone Fax

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
 By Senior Vice President and Deputy General Counsel
 (Name) (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

Add Remove View

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

Add Remove View

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"),¹ the National Association of Securities Dealers, Inc. ("NASD") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to expand NASD's current Order Audit Trail System (OATS) exemptive authority to include recording requirements. Below is the text of the proposed rule change.

Proposed new language is underlined; proposed deletions are in brackets.²

* * * * *

6950. Order Audit Trail System

* * * * *

6955. Order Data Transmission Requirements

(a) through (c) No Change.

[(d) Exemptions]

[(1) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the order data transmission requirements of this Rule for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:]

¹ 15 U.S.C. 78s(b)(1).

² The proposed changes indicated herein are based on rule text approved by the SEC on September 28, 2005, which become effective on May 8, 2006. See Securities Exchange Act Release No. 52521 (Sept. 28, 2005), 70 FR 57909 (Oct. 4, 2005) (File No. SR-NASD-00-23).

[(A) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;]

[(B) the member has annual revenues of less than \$2 million;]

[(C) the member does not conduct any market making activities in Nasdaq Stock Market equity securities;]

[(D) the member does not execute principal transactions with its customers (with limited exception for principal transactions executed pursuant to error corrections); and]

[(E) the member does not conduct clearing or carrying activities for other firms.]

[(2) An exemption provided pursuant to this paragraph (d) shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this paragraph (d), a member meeting the criteria set forth in paragraph (d)(1) may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.]

[(3) This paragraph shall be in effect until May 8, 2011.]

* * * * *

6958. Exemption to the Order Recording and Data Transmission Requirements

(a) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking

into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the recording and order data transmission requirements of Rules 6954 and 6955, respectively, for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:

(1) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;

(2) the member has annual revenues of less than \$2 million;

(3) the member does not conduct any market making activities in Nasdaq Stock Market equity securities;

(4) the member does not execute principal transactions with its customers (with limited exception for principal transactions executed pursuant to error corrections); and

(5) the member does not conduct clearing or carrying activities for other firms.

(b) An exemption provided pursuant to this Rule shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this Rule, a member meeting the criteria set forth in paragraph (a) above may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.

(c) This Rule shall be in effect until May 8, 2011.

* * * * *

9600. PROCEDURES FOR EXEMPTIONS

9610. Application

(a) Where to File

A member seeking exemptive relief as permitted under Rules 1021, 1050, 1070, 2210, 2315, 2320, 2340, 2520, 2710, 2720, 2790, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3150, 3210, 3230, 3350, 695[5]8, 8211, 8212, 8213, 11870, or 11900, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of NASD and provide a copy of the application to the Office of General Counsel of NASD.

(b) and (c) No Change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Governors of NASD ("Board") and authorized for filing with the SEC pursuant to a delegation of authority granted by the Board at its meeting on July 31, 2003 to the General Counsel of NASD Regulatory Policy and Oversight (or his officer designee) ("Delegation of Authority") to file, without further specific Board authorization, rule changes as may be necessary to effectuate current provisions within existing rules that allow NASD staff to grant exemptions or to amend rules and rule proposals to provide for exemptions.

Counsel for The Nasdaq Stock Market and NASD Dispute Resolution were 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 staff will advise the Board of any action taken pursuant to the Delegation of Authority. No other action by NASD is necessary for the filing of this proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

The effective date of the proposed rule change will be May 8, 2006, if approved prior to that date; otherwise, the effective date will be the date of SEC approval.

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

(a) Purpose

On September 28, 2005, the SEC approved amendments to the OATS Rules (Rules 6950 through 6957) which, among other things, implement the final phase of OATS (OATS Phase III) relating to manual orders and permit NASD to grant exemptive relief from the OATS reporting requirements for manual orders.³ The amendments become effective on May 8, 2006. The new exemptive authority permits NASD to grant exemptive relief only to those members that meet specified criteria.⁴ The narrow scope is

³ See Securities Exchange Act Release No. 52521 (Sept. 28, 2005), 70 FR 57909 (Oct. 4, 2005) (File No. SR-NASD-00-23).

⁴ At a minimum, members must meet the following criteria to be eligible to request an exemption to the OATS reporting requirements for manual orders: (1) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud; (2) the member has annual revenues of less than \$2 million; (3) the member does not conduct any market making activities in Nasdaq Stock Market equity securities; (4) the member does not execute principal transactions with its customers (with

generally intended to permit NASD to grant relief only to smaller member firms where the reporting of such information would be unduly burdensome or where temporary relief from the rules (in the form of additional time to achieve compliance) would permit the member to avoid unnecessary expense or hardship.

NASD's current exemptive authority is further limited in that it only permits NASD to relieve members of their obligations to report to NASD OATS information. Therefore, members that are granted an exemption still must record all information required under the OATS Rules and maintain such information in an electronic format – they are exempt only from reporting or submitting that information to NASD on a daily basis.

Certain smaller members firms that meet the criteria to request an exemption from the reporting requirements have raised concerns about having to comply with the OATS recording requirements. Specifically, they have indicated that even if they ultimately are granted an exemption from the reporting requirements, complying with the OATS recording requirements will impose significant burdens and costs on their firms.

NASD understands the concerns raised by these firms and believes that expanding its current exemptive authority to include recording requirements will greatly assist these smaller member firms by providing such firms more time to determine the best mechanism for complying with the OATS requirements. At the same time, NASD does not believe that such an exemption will have a material impact on NASD's regulatory program because members currently are required to capture and maintain much of the

limited exceptions for error corrections); and (5) the member does not conduct clearing or carrying activities for other firms.

data via other NASD and SEC rules (e.g., NASD Rule 3110 and SEC Rule 17a-3) and any exemption granted will be for a limited time period.

If this expansion of NASD's exemptive authority is approved, NASD intends to grant exemptions from the OATS recording and reporting requirements for manual orders for a period of six months to those members that meet the minimum required criteria. This exemptive relief is intended to provide such members additional time to determine and implement an effective mechanism for recording and reporting OATS information to NASD.

In this regard, NASD has developed several new enhancements to NASD's OATS web interface, which are designed to reduce significantly the OATS recording and reporting burdens for manual firms with limited order volume.⁵ Specifically, the upgrades to the OATS web interface, which is available at no cost to members, will greatly improve usability and significantly reduce the number of fields users are required to enter when recording an OATS event. The enhanced web interface will enable a user to submit the data to OATS, as well as download the data to its own system prior to submission to allow the user to maintain on its own system a record of events submitted to OATS.⁶

During the six-month exemption period, NASD will be evaluating the enhanced

⁵ While the enhanced OATS web interface is designed to reduce significantly the OATS recording and reporting burdens for manual firms with limited order volume, the enhanced web interface is available as a mechanism for recording and reporting OATS information to all eligible member firms, including member firms already required to report to NASD during OATS Phase I and Phase II.

⁶ The testing environment for the web interface enhancements will be available on April 24, 2006, and the production environment will be available on May 8, 2006.

web interface functionality to determine whether it reduces significantly the reporting burdens for smaller member firms. The availability of an effective OATS web interface will be a major factor in NASD's decision to grant further exemptions after the initial six-month exemptive period expires. For this reason, NASD will be strongly recommending that members granted an exemption contact NASD immediately to begin testing usage of the web interface enhancements. As NASD and member firms gain experience with the web interface, NASD will be in a better position to evaluate and consider the effectiveness of web interface for OATS requirements and whether any future exemptive relief beyond the initial six-month time frame is appropriate. Notwithstanding the effectiveness of the web interface, NASD may decide to grant further exemptions to certain smaller member firms where complying with the OATS recording and reporting requirements for manual orders will impose significant burdens and costs on their firms.

As noted in Item 2 of this filing, the effective date of the proposed rule change will be May 8, 2006, if approved prior to that date; otherwise, the effective date will be the date of SEC approval.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁷ which requires, among other things, that NASD rules 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 expanding NASD's OATS exemptive authority will provide smaller

⁷ 15 U.S.C. 78o-3(b)(6).

member firms additional time to determine an appropriate mechanism for complying with the OATS requirements, while not materially impacting NASD's regulatory program.

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.

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

While NASD did not specifically solicit comment on the proposed rule change, NASD received one written comment letter regarding the scope of the exemptive authority set forth in Rule 6955(d).⁸ The commenter requests that NASD broaden its current exemptive authority to include recording requirements. Specifically, the commenter argues that NASD's exemptive authority was intended to include the requirement to record information required under the OATS Rules and maintain such information in an electronic format. The commenter contends that their firm, as well as other firms, were confused that the current exemption from the OATS reporting requirements included only the narrow exemption from the requirement to transmit OATS data to NASD. The commenter further contends that the distinction between the transmission requirement and the electronic retention and collection of information was not highlighted nor discussed. As noted above, NASD is proposing to expand NASD's OATS exemptive authority to include recording requirements.

6. Extension of Time Period for Commission Action

⁸ See Letter from Wachtel & Co., Inc. to Paul J. McKenney, NASD, dated February 1, 2006.

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.⁹

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 Act¹⁰ for approving the proposed rule change prior to the 30th day after its publication in the Federal Register. To provide members eligible for an exemption adequate notice as to whether they will be required to comply with the OATS recording requirement on May 8, 2006, NASD requests the Commission 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.

9. Exhibits

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

Exhibit 2. Letter from Wachtel & Co., Inc. to Paul J. McKenney, NASD, dated February 1, 2006.

⁹ 15 U.S.C. 78s(b)(2).

¹⁰ 15 U.S.C. 78s(b)(2).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2006-040)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Expand NASD's Order Audit Trail System Exemptive Authority to Include Recording Requirements

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") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

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

NASD is proposing to expand NASD's current Order Audit Trail System (OATS) exemptive authority to include recording requirements. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.³

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The proposed changes indicated herein are based on rule text approved by the SEC on September 28, 2005, which become effective on May 8, 2006. See

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6950. Order Audit Trail System

* * * * *

6955. Order Data Transmission Requirements

(a) through (c) No Change.

[(d) Exemptions]

[(1) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the order data transmission requirements of this Rule for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:]

[(A) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;]

[(B) the member has annual revenues of less than \$2 million;]

[(C) the member does not conduct any market making activities in Nasdaq Stock Market equity securities;]

[(D) the member does not execute principal transactions with its customers (with limited exception for principal transactions executed

pursuant to error corrections); and]

[(E) the member does not conduct clearing or carrying activities for other firms.]

[(2) An exemption provided pursuant to this paragraph (d) shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this paragraph (d), a member meeting the criteria set forth in paragraph (d)(1) may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.]

[(3) This paragraph shall be in effect until May 8, 2011.]

* * * * *

6958. Exemption to the Order Recording and Data Transmission Requirements

(a) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the recording and order data transmission requirements of Rules 6954 and 6955, respectively, for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:

- (1) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;
- (2) the member has annual revenues of less than \$2 million;

(3) the member does not conduct any market making activities in Nasdaq Stock Market equity securities;

(4) the member does not execute principal transactions with its customers (with limited exception for principal transactions executed pursuant to error corrections); and

(5) the member does not conduct clearing or carrying activities for other firms.

(b) An exemption provided pursuant to this Rule shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this Rule, a member meeting the criteria set forth in paragraph (a) above may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.

(c) This Rule shall be in effect until May 8, 2011.

* * * * *

9600. PROCEDURES FOR EXEMPTIONS

9610. Application

(a) Where to File

A member seeking exemptive relief as permitted under Rules 1021, 1050, 1070, 2210, 2315, 2320, 2340, 2520, 2710, 2720, 2790, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3150, 3210, 3230, 3350, 695[5]8, 8211, 8212, 8213, 11870, or 11900, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of NASD and provide a copy

of the application to the Office of General Counsel of NASD.

(b) and (c) No Change.

* * * * *

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

On September 28, 2005, the SEC approved amendments to the OATS Rules (Rules 6950 through 6957) which, among other things, implement the final phase of OATS (OATS Phase III) relating to manual orders and permit NASD to grant exemptive relief from the OATS reporting requirements for manual orders.⁴ The amendments become effective on May 8, 2006. The new exemptive authority permits NASD to grant exemptive relief only to those members that meet specified criteria.⁵ The narrow scope is

⁴ See Securities Exchange Act Release No. 52521 (Sept. 28, 2005), 70 FR 57909 (Oct. 4, 2005) (File No. SR-NASD-00-23).

⁵ At a minimum, members must meet the following criteria to be eligible to request an exemption to the OATS reporting requirements for manual orders: (1) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and

generally intended to permit NASD to grant relief only to smaller member firms where the reporting of such information would be unduly burdensome or where temporary relief from the rules (in the form of additional time to achieve compliance) would permit the member to avoid unnecessary expense or hardship.

NASD's current exemptive authority is further limited in that it only permits NASD to relieve members of their obligations to report to NASD OATS information. Therefore, members that are granted an exemption still must record all information required under the OATS Rules and maintain such information in an electronic format – they are exempt only from reporting or submitting that information to NASD on a daily basis.

Certain smaller members firms that meet the criteria to request an exemption from the reporting requirements have raised concerns about having to comply with the OATS recording requirements. Specifically, they have indicated that even if they ultimately are granted an exemption from the reporting requirements, complying with the OATS recording requirements will impose significant burdens and costs on their firms.

NASD understands the concerns raised by these firms and believes that expanding its current exemptive authority to include recording requirements will greatly assist these smaller member firms by providing such firms more time to determine the best mechanism for complying with the OATS requirements. At the same time, NASD does

within the last ten years to any disciplinary action involving fraud; (2) the member has annual revenues of less than \$2 million; (3) the member does not conduct any market making activities in Nasdaq Stock Market equity securities; (4) the member does not execute principal transactions with its customers (with limited exceptions for error corrections); and (5) the member does not conduct clearing or carrying activities for other firms.

not believe that such an exemption will have a material impact on NASD's regulatory program because members currently are required to capture and maintain much of the data via other NASD and SEC rules (e.g., NASD Rule 3110 and SEC Rule 17a-3) and any exemption granted will be for a limited time period.

If this expansion of NASD's exemptive authority is approved, NASD intends to grant exemptions from the OATS recording and reporting requirements for manual orders for a period of six months to those members that meet the minimum required criteria. This exemptive relief is intended to provide such members additional time to determine and implement an effective mechanism for recording and reporting OATS information to NASD.

In this regard, NASD has developed several new enhancements to NASD's OATS web interface, which are designed to reduce significantly the OATS recording and reporting burdens for manual firms with limited order volume.⁶ Specifically, the upgrades to the OATS web interface, which is available at no cost to members, will greatly improve usability and significantly reduce the number of fields users are required to enter when recording an OATS event. The enhanced web interface will enable a user to submit the data to OATS, as well as download the data to its own system prior to

⁶ While the enhanced OATS web interface is designed to reduce significantly the OATS recording and reporting burdens for manual firms with limited order volume, the enhanced web interface is available as a mechanism for recording and reporting OATS information to all eligible member firms, including member firms already required to report to NASD during OATS Phase I and Phase II.

submission to allow the user to maintain on its own system a record of events submitted to OATS.⁷

During the six-month exemption period, NASD will be evaluating the enhanced web interface functionality to determine whether it reduces significantly the reporting burdens for smaller member firms. The availability of an effective OATS web interface will be a major factor in NASD's decision to grant further exemptions after the initial six-month exemptive period expires. For this reason, NASD will be strongly recommending that members granted an exemption contact NASD immediately to begin testing usage of the web interface enhancements. As NASD and member firms gain experience with the web interface, NASD will be in a better position to evaluate and consider the effectiveness of web interface for OATS requirements and whether any future exemptive relief beyond the initial six-month time frame is appropriate. Notwithstanding the effectiveness of web interface, NASD may decide to grant further exemptions to certain smaller member firms where complying with the OATS recording and reporting requirements for manual orders will impose significant burdens and costs on their firms.

The effective date of the proposed rule change will be May 8, 2006, if approved prior to that date; otherwise, the effective date will be the date of SEC approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸ which requires, among other things, that NASD rules be

⁷ The testing environment for the web interface enhancements will be available on April 24, 2006, and the production environment will be available on May 8, 2006.

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 expanding NASD's OATS exemptive authority will provide smaller member firms additional time to determine an appropriate mechanism for complying with the OATS requirements, while not materially impacting NASD's regulatory program.

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

While NASD did not specifically solicit comment on the proposed rule change, NASD received one written comment letter regarding the scope of the exemptive authority set forth in Rule 6955(d).⁹ The commenter requests that NASD broaden its current exemptive authority to include recording requirements. Specifically, the commenter argues that NASD's exemptive authority was intended to include the requirement to record information required under the OATS Rules and maintain such information in an electronic format. The commenter contends that their firm, as well as other firms, were confused that the current exemption from the OATS reporting requirements included only the narrow exemption from the requirement to transmit

⁸ 15 U.S.C. 78o-3(b)(6).

⁹ See Letter from Wachtel & Co., Inc. to Paul J. McKenney, NASD, dated February 1, 2006.

OATS data to NASD. The commenter further contends that the distinction between the transmission requirement and the electronic retention and collection of information was not highlighted nor discussed. As noted above, NASD is proposing to expand NASD's OATS exemptive authority to include recording requirements.

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 Act¹⁰ for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NASD and, in particular, the requirements of Section 15A of the Act and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will provide members eligible for an exemption adequate notice as to whether they will be required to comply with the OATS recording requirement on May 8, 2006.

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

¹⁰ 15 U.S.C. 78s(b)(2).

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- 2006-040 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-040. 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. 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 File Number SR-NASD-2006-040 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.¹¹

Nancy M. Morris

Secretary

¹¹ 17 CFR 200.30-3(a)(12).

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BROKERS & UNDERWRITERS

202-698-1144

February 1, 2006

Paul J. McKenney
NASD - Asst. Director, OATS
9509 Key West Avenue
Rockville, MD 20850

Re: Exemption - OATS Phase III

Dear Paul:

This is a follow-up to our conversation earlier this month regarding the OATS Phase III exemption for certain small firms. We urgently request that this provision be broadened to include the relief that was intended by the original drafters. An error has occurred – through the fault of no individual – but from simple miscommunication and the complexity of the Rule. We strongly believe that this exemption was intended to cover the requirement to collect and obtain data in electronic form as well as the transmission requirements. This is based on a wealth of extensive writing and discussion of these matters over a period of several years.

Our most fundamental premise for the belief that a broader exemption was intended is a discussion held at the SEC on July 31, 2000. In attendance were the undersigned and Belinda Blaine, then Asst. Director of the Division of Market Regulation; Steven Williams (we apologize that we do not recall his position, but believe he had technical expertise with respect to OATS); and Leo Wang, from the Division of Enforcement. Prior to this meeting, we had written at length on the burden of OATS in a letter dated January 6, 2000, a copy of which is enclosed. At the conclusion of this meeting, the following exchange took place:

Mr Williams: Do you need an exemption from every part of the Rule?

Bonnie Wachtel: Only the transmission requirement. I have no problem with providing the information; we're already collecting most of it anyway.

Of course, what was meant was that we're already collecting it on paper tickets. The entire thrust of our letter – and of that discussion – was the burden of duplicate recording of manual and electronic data. We assumed that the requirements for electronic collection and retention of data were only in place so that the data could be held in a transmissible form. Without a transmission requirement, we assumed the requirement for duplicate electronic recording would be seen as excessive and unnecessary. The attendees at the meeting must have understood this, because without the broader interpretation, our letter and our entire discussion would have been incoherent.

This confusion is also apparent through subsequent publications on OATS. Most recently, we provided comments to the SEC (by letter dated July 18, 2005, a copy of which is attached) to the

NASD's most recent proposed amendment on OATS, which included the exemption for certain small firms. The language in the SEC release referred to an exemption from "the OATS reporting requirements" – which is easily confused with the entire electronic collection/reporting system. In our letter, we again discussed the burden of the Rule –arguing for a broader and more durable exemption. That letter also is incomprehensible if the proposed relief was only contemplated as a narrow exemption from the need to transmit data to the NASD. Perhaps more importantly, in all of our reading on this subject – which includes every release mentioning the exemption provision and digest of comments on that issue – we have never seen the distinction between transmission and electronic retention/collection of data highlighted or even mentioned. We were first made aware of the problem by a notice, posted after the rule was enacted, on the NASD website. We certainly do not blame the regulators for the lack of earlier clarity on this subject; the fact that this provision is only of interest to a tiny minority of the industry is more likely at fault. However, in view of our confusion – and we were perhaps following this issue more intensely than any other single firm – we believe it is reasonable to suspect that a large swath of other firms affected by this Rule were similarly confused on the issue.

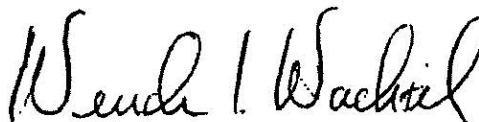
We realize that amending the Rule at this stage imposes a burden. It should be done nonetheless. In preparation for its implementation, we have contacted all the software vendors for which the NASD provided referrals, and have received exactly one returned call. If we engage that firm, our securities business is essentially in thrall to them, with no alternative vendor available. In addition, the vast majority of the burden of duplicate recording remains. We are extremely grateful for the consideration shown by the NASD and the SEC, throughout this process, to the need for small firm relief. To have that relief so significantly reduced at this late stage due to confusion we believe would be a regulatory error of no small proportion.

In closing, let us repeat the premise of this letter and of the foundation of our understanding for all of our prior writing on OATS: if a firm is exempt from the requirement to transmit the data, there should be no requirement to collect and retain it in transmissible form. We remain ready, of course, to provide all the data that the rule requires in the form of paper tickets.

Sincerely yours,



Bonnie K Wachtel, CEO



Wendie L. Wachtel, COO