securities association.[8] In particular, the Commission believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,[9] which requires, among other things, that NASD's 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. The Commission believes that a random selection function incorporated into the NASD Dispute Resolution arbitration forum provides a fair and equitable system for parties to select arbitrators.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[10] that the proposed rule change (SR–NASD–2004–164), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[11]

Jill M. Petersen,

Assistant Secretary.

[FR Doc. E5–1103 Filed 3–14–05; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–51338; File No. SR–NASD–2003–141]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Adopt an Additional Mark-Up Policy for Transactions in Debt Securities Except Municipal Securities

March 9, 2005.

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 September 17, 2003, 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.[3] On June 29, 2004, NASD filed Amendment No. 1 to the proposed rule change.[4] On February 17, 2005, NASD filed Amendment No. 2 to the proposed rule change.[5] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NASD is proposing to adopt a second interpretation, proposed IM–2440–2, to Rule 2440 to provide additional mark-up guidance for transactions in debt securities except municipal securities. Below is the text of the proposed rule change. Proposed new language is in *italics*. Text in bold would appear in italics in the Rule as published in the NASD Manual.

* * * * *

IM–2440–*1*. Mark-Up Policy

* * * * *

IM–2440–*2*. Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities [1]

[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.

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

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).

*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.*

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 after the dealer's contemporaneous trades, or (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.

In instances other than those pertaining to a Specified Institutional Trade, 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

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[8] In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78(c)(f).

[9] 15 U.S.C. 78*o*–3(b)(6).

[10] 15 U.S.C. 78s(b)(2).

[11] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Commission staff made certain changes to the description of the proposed rule change with the consent of NASD, to enhance clarity and accuracy. Telephone conversation between Sharon K. Zackula, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, Richard Strasser, Attorney-Fellow, and Andrew Shipe, Special Counsel, Division of Market Regulation, Commission, March 3, 2005.

[4] *See* letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine England, Assistant Director, Division of Market Regulation, Commission, dated June 29, 2004.

[5] *See* Form 19b–4, filed February 17, 2005. Amendment No. 2 replaced the previous filings in their entirety.

prevailing market price, or where interest rates or the credit quality of the security changed significantly after the dealer's contemporaneous trades, the most important or first pricing factor that should be taken into consideration in establishing prevailing market price for a mark-up or a mark-down is prices of any contemporaneous inter-dealer transactions in the security in question. In the absence of inter-dealer transactions, the second factor that should be taken into consideration in establishing the prevailing market prices for mark-ups (mark-downs) to customers is prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security. For actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations, may be used in the absence of inter-dealer or institutional transactions (described in the preceding sentence) in determining prevailing market price for customer mark-ups (mark-downs).

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 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 one may attribute to these other factors 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 above, the relative spread of the quotations in the similar security to the quotations in the subject security.

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.

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.

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.

The degree to which a security is ''similar,'' as that term is used in this Interpretation, 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.

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.

* * * * *

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

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

Introduction

Under NASD Rule 2440, ''Fair Prices and Commissions,'' a member is required to sell securities to a customer at a fair price.[6] When a member acts in

[6] NASD Rule 2440 specifically provides that a member is required to sell a security at a fair price

Continued

a principal capacity and sells a security to a customer, a dealer generally ''marks up'' the security, increasing the total price the customer pays. Conversely, when buying a security from a customer, a dealer that is a principal generally ''marks down'' the security, reducing the total proceeds the customer receives. IM–2440, ''Mark-Up Policy,'' provides additional guidance on mark-ups and fair pricing of securities transactions with customers.[7] Both Rule 2440 and IM–2440 apply to transactions in debt securities and IM–2440 provides that mark-ups for transactions in common stock are customarily higher than those for bond transactions of the same size.[8]

Under Rule 2440 and IM–2440, when a customer buys a security from a dealer, the customer's total purchase price, and the mark-up included in the price, must be fair and reasonable. Similarly, when a customer sells a security to a dealer, the customer's total proceeds from the sale, which were reduced by the mark-down, and the mark-down, must be fair and reasonable. A key step in determining whether a mark-up (mark-down) is fair and reasonable is correctly identifying the *prevailing market price* of the security, which is the basis from which the mark-up (mark-down) is calculated.[9]

The proposed interpretation, ''IM–2440–2, Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities'' (''Proposed Interpretation''), provides additional guidance on mark-ups (mark-downs) in debt securities transactions, except municipal securities transactions.[10] The Proposed Interpretation addresses two fundamental issues in debt securities transactions: (1) How does a dealer correctly identify the prevailing market price of a debt security; and (2) what is a ''similar'' security and when may it be considered in determining the prevailing market price.

Prevailing Market Price

The Proposed Interpretation provides that when a dealer calculates a mark-up (or mark-down), the best measure of the prevailing market price of the security is presumptively the dealer's contemporaneous cost (proceeds).[11] Further, the dealer may look to countervailing evidence of the prevailing market price *only* where the dealer, when selling a security, 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 buying a security from a customer, the dealer may look to countervailing evidence of the prevailing market price 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.

The presumption that contemporaneous cost is the best evidence of prevailing market price is found in many cases and NASD decisions, and its specific applicability to debt securities transactions was addressed by the SEC as early as 1992 in *F.B. Horner & Associates, Inc.,* 50 S.E.C. 1063 (1992), *aff'd,* 994 F.2d 61 (2d Cir. 1993) (''*F.B. Horner*''), a debt mark-up case. In *F.B. Horner,* the SEC stated: ''We have consistently held that where, as in the present case, a dealer is not a market maker, the best evidence of the current market, absent countervailing evidence, is the dealer's contemporaneous cost.'' *F.B. Horner,* 50 S.E.C. at 1065–66.[12] The basis for the standard was also restated. ''That standard, which has received judicial approval, reflects the fact that the prices paid for a security by a dealer in transactions closely related in time to his retail sales are normally a highly reliable indication of the prevailing market.'' *F.B. Horner,* 50 S.E.C. at 1066 (citations omitted).

The Proposed Interpretation recognizes that in some circumstances a dealer may seek to overcome the presumption that the dealer's own contemporaneous cost (proceeds) are the prevailing market price of the subject security for determining a mark-up (mark-down), and sets forth a process for identifying a value other than the dealer's own contemporaneous cost (proceeds).

Cases Where the Presumption May Be Overcome

A dealer may seek to overcome the presumption that its contemporaneous cost or proceeds are not indicative of the prevailing market price in either of two instances: (1) Where the dealer's contemporaneous trade was with an institutional account with which the dealer regularly effects transactions in the same or a similar security under certain conditions, or (2) where interest rates or the credit quality of the security changed significantly after the dealer's contemporaneous trades.

Specified Institutional Trades

In instances when the dealer establishes that the dealer's contemporaneous trade was a ''Specified Institutional Trade,'' to overcome the presumption that the dealer's contemporaneous cost (or proceeds) is the best measure of the prevailing market price, the dealer must provide evidence of the then prevailing market price in the subject security by referring *exclusively* to inter-dealer trades in the same security executed

to customers, ''taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit * * *.'' Rule 2320, ''Best Execution and Interpositioning,'' also addresses a member's obligation in pricing customer transactions. In any transaction for or with a customer, NASD Rule 2320 requires a member to ''use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy and sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.'' Together, Rule 2440 and Rule 2320 impose broad responsibilities on broker-dealers to price customer transactions fairly. *Cf.* ''Review of Dealer Pricing Responsibilities,'' Municipal Securities Rulemaking Board (''MSRB'') Notice 2004–3 (January 26, 2004) (discussing MSRB Rules requiring municipal securities dealers to ''exercise diligence in establishing the market value of [a] security and the reasonableness of the compensation received on [a] transaction'').

[7] The terms ''mark-up'' and ''mark-down'' are not found in Rule 2440, but are used in IM–2440. Statements regarding mark-ups also apply generally to mark-downs unless mark-downs are discussed specifically in a separate statement.

[8] IM–2440(b)(1).

[9] The Commission notes that IM–2440 states: ''It shall be deemed a violation of Rule 2110 and Rule 2440 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable.''

[10] MSRB Rule G–30, ''Prices and Commissions,'' applies to transactions in municipal securities, and requires that a municipal securities dealer engaging in a transaction as a principal with a customer must buy or sell securities at an aggregate price that is ''fair and reasonable.''

[11] Of course, if a dealer violates NASD Rule 2320, the dealer's contemporaneous cost (proceeds) in such transactions would not be a reliable indicator of the prevailing market price for the purpose of determining a mark-up or mark-down. If a dealer violates Rule 2320 because the dealer fails to exercise diligence, fails to negotiate at arms length in the market, or engages in fraudulent transactions, including those entered into in collusion with other dealers or brokers, including inter-dealer brokers, the price that the dealer obtains is not a price reflecting market forces, and, therefore, is not a valid indicator of the prevailing market price and should not be used to calculate a mark-up (mark-down). In addition, if a dealer that is not a party to a transaction engages in conduct to improperly influence the pricing of such transaction, the dealer could not properly use the execution price as the basis from which to compute a mark-up (mark-down) because the execution price does not represent the prevailing market price of the security.

[12] The term ''market maker'' is defined in Section 3(a)(38) of the Act [15 U.S.C. 78c(a)(38)] and a dealer in debt securities must meet the legal requirements of Section 3(a)(38) to be considered a market maker.

contemporaneously with the dealer's Specified Institutional Trade.[13]

Transactions Other Than Specified Institutional Trades.

In instances other than those pertaining to a Specified Institutional Trade, where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (proceeds) provide the best measure of the prevailing market price, or where interest rates or credit quality of the security changed significantly, the dealer must follow a process for determining prevailing market price, considering certain factors in the appropriate order, as set forth in the Proposed Interpretation. Initially, a dealer must look to three factors or measures in the order they are presented (the ''Hierarchy'') to determine prevailing market price. The most important and first factor in the Hierarchy is the pricing of any contemporaneous inter-dealer transactions in the same security. The second most important factor in the Hierarchy recognizes the role of certain large institutions in the fixed income securities markets. In the absence of inter-dealer transactions, the second factor a dealer must consider is the prices of contemporaneous dealer purchases in the security in question from institutional accounts with which any dealer regularly effects transactions in the same security.[14] If contemporaneous inter-dealer trades or dealer-institutional trades in the same security are not available, a dealer must look to the third factor in the Hierarchy, which may be applied only to actively traded securities. For actively traded securities, a dealer is required to look to contemporaneous bid (offer) quotations for the security in question for proof of the prevailing market price if such quotations are made through an inter-dealer mechanism through which transactions generally occur at the displayed quotations.[15]

Additional Factors That May Be Considered in Cases Other Than Specified Institutional Trades

If none of the three factors in the Hierarchy is available, the dealer then may take into consideration the non-exclusive list of four factors in the Proposed Interpretation in trying to establish prevailing market price using a measure other than the dealer's contemporaneous cost (proceeds). In contrast to the Hierarchy of three factors discussed above, a dealer is not required to consider the four factors below in a particular order. The four factors reflect the particular nature of the debt markets and the trading and valuation of debt securities. They are:

- 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 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).

When applying one or more of the four factors, a dealer must consider that the ultimate evidentiary issue is whether the prevailing market price of the security will be correctly identified. As stated in the Proposed Interpretation, the relative weight one may attribute to these other factors 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, the relative spread of the quotations in the ''similar'' security to the quotations in the subject security.

Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, a member may consider as a factor in determining the prevailing market price the prices or yields derived from economic 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). However, dealers may not use any economic model to establish the prevailing market price for mark-up (mark-down) purposes, except in limited instances where none of the three factors in the Hierarchy apply, the subject security is infrequently traded, and the security is of such low credit quality (*e.g.*, a distressed debt security) that a dealer cannot identify a ''similar'' security.[16]

The final principle in the Proposed Interpretation regarding prevailing market price addresses the use of pricing information from isolated transactions or quotations. The Proposed Interpretation provides that ''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.''

''Similar'' Securities

The definition of ''similar'' security, and the uses and limitations of ''similar'' securities are the second part of the Proposed Interpretation. Several of the factors referenced above to which

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

[14] Contemporaneous dealer sales with such institutional accounts would be used to calculate a mark-down. If a dealer has overcome the presumption by establishing that interest rates or the credit quality of the security changed significantly after the dealer's trade, any inter-dealer or dealer-institutional trades in the same security *that occurred prior to the event* would not be valid measures of the prevailing market price as such transactions would be subject to the same imperfection.

[15] A dealer also is subject to the process of establishing prevailing market price, including the analysis under the Hierarchy and the other factors discussed below, where the dealer has not engaged in trading in the subject security for an extended period and therefore can evidence that it has no contemporaneous cost (proceeds) to refer to as a basis for computing a mark-up (mark-down).

[16] When a dealer seeks to identify prevailing market price using information other than the dealer's contemporaneous cost or contemporaneous proceeds, the dealer must be prepared to provide evidence that will establish the dealer's basis for not using contemporaneous cost (proceeds), and information about the other values reviewed (*e.g.*, the specific prices and/or yields of securities that were identified as similar securities) in order to determine the prevailing market price of the subject security. If a firm relies upon pricing information from a model the firm uses or has developed, the firm must be able to provide information that was used on the day of the transaction to develop the pricing information (*i.e.*, the data that was input, and the data that the model generated and the firm used to arrive at prevailing market price).

a dealer may refer when determining the prevailing market price as a value that is other than the dealer's contemporaneous cost (proceeds) require a dealer to identify one or more ''similar'' securities.

The Proposed Interpretation provides that a ''similar'' security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment. In addition, at a minimum, a dealer must be able to fairly estimate the market yield for the subject security from the yields of ''similar'' securities. Finally, to aid members in identifying ''similar'' securities when appropriate, the Proposed Interpretation sets forth a list of non-exclusive factors to determine the similarity between the subject security and one or more other securities. The non-exclusive list of factors that can be used to assess similarity includes 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 that 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 in 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 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.

The provisions regarding ''similar'' securities, if adopted, would affirm explicitly, for the first time, that it may be appropriate under specified circumstances to refer to ''similar'' securities to determine prevailing market price.[17]

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

2. Statutory Basis

NASD believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,[18] which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that clarifying the standard for correctly identifying the prevailing market price of a debt security for purposes of calculating a mark-up (mark-down), clarifying the additional obligations of a member when it seeks to use a measure other than the member's own contemporaneous cost (proceeds) as the prevailing market price, and confirming that similar securities may be used in certain instances to determine the prevailing market price are measures designed to prevent fraudulent practices, promote just and equitable principles of trade, and protect investors and the public interest.

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

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

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

Written comments were neither solicited nor received.

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

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, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number SR–NASD–2003–141 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609.

All submissions should refer to File Number SR–NASD–2003–141. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All

[17] The Proposed Interpretation also states that, for certain securities, there are no ''similar'' securities. Specifically, when a debt security's value and pricing is based substantially, and is highly dependent, on the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to make interest payments and otherwise meet the specific obligations of the security, in most cases other securities will not be sufficiently ''similar,'' and therefore, may not be used to establish prevailing market price of the subject security. As noted above, NASD may consider a dealer's pricing information obtained from an economic model to establish prevailing market price, when ''similar'' securities do not exist and facts and circumstances have combined to create a price information void in the subject security. In addition, as provided in the Proposed Interpretation, NASD also may look to economic models other than the dealer's to make determinations as to the prevailing market price of a security.

[18] 15 U.S.C. 78o–3(b)(6).

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–2003–141 and should be submitted on or before April 5, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[19]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. E5–1104 Filed 3–14–05; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–51329; File No. SR-NYSE–2004–71]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. To Amend NYSE Rule 104 Regarding the Requirement That Specialists Obtain Floor Official Approval for Destabilizing Dealer Account Transactions in ETFs

March 8, 2005.

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 December 15, 2004, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NYSE. On February 28, 2005, the NYSE submitted Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange is proposing to amend NYSE Rule 104 (Dealings by Specialists) to remove the requirement that specialists obtain Floor Official approval for destabilizing dealer account transactions in investment company units and Trust Issued Receipts (collectively referred to as ''Exchange Traded Funds'' or ''ETFs''). Below is the text of the proposed rule change, as amended. Proposed new language is *italicized*; proposed deletions are in [brackets].

Dealings by Specialists

Rule 104

(a) No specialist shall effect on the Exchange purchases or sales of any security in which such specialist is registered, for any account in which he, his member organization or any other member, allied member, or approved person, (unless an exemption with respect to such approved person is in effect pursuant to Rule 98) in such organization or officer or employee thereof is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market, or to act as an odd-lot dealer in such security.

(b) No change.

Supplementary Material

Functions of Specialists

.10 Regular specialists.—Any member who expects to act regularly as specialist in any listed stock and to solicit orders therein must be registered as a regular specialist.

The function of a member acting as regular specialist on the Floor of the Exchange includes, in addition to the effective execution of commission orders entrusted to him, the maintenance, in so far as reasonably practicable, of a fair and orderly market on the Exchange in the stocks in which he is so acting. This is more specifically set forth in the following:

(1)–(6) No change.

(7) The requirement to obtain Floor Official approval for transactions for a specialist's own account contained in subparagraphs (5)(i)(A), (B) and (6)(i)(A) above shall not apply to transactions effected [for the purpose of bringing the price of] *in* an investment company unit (the ''unit''), as that term is defined in Section 703.16 of the Listed Company Manual, or a Trust Issued Receipt (the ''receipt'') as that term is defined in Rule 1200 [into parity with the value of the index on which the unit is based, with the net asset value of the securities comprising the unit or the receipt, or with a futures contract on the value of the index on which the unit is based]. Nevertheless such transactions must be effected in a manner that is consistent with the maintenance of a fair and orderly market and with the other requirements of this rule and the supplementary material herein.

No changes to remainder of rule.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposal. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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

The Exchange proposes to eliminate the current restriction on the ability of specialists to buy ETFs on plus ticks or sell ETFs on minus ticks without Floor Official approval for the transactions.

NYSE Rule 104 governs specialists' dealings in their specialty stocks. In particular, NYSE Rules 104.10(5) and (6) describe certain types of transactions that are not to be effected unless they are reasonably necessary to render the specialist's position adequate to the needs of the market. The Exchange states that, in effect, these restrictions generally require specialists' transactions for their own accounts to be ''stabilizing'' (*i.e.,* against the trend of the market) and prohibit specialists from making transactions that are ''destabilizing'' (*i.e.,* with the market trend by buying on plus ticks and selling on minus ticks), except with the approval of a Floor Official.

The Exchange is proposing to remove these restrictions in connection with destabilizing transactions in ETFs by specialists for their own account. These products are based on a portfolio of underlying securities and are derivatively priced based upon the value of those securities. Therefore, according to the Exchange, specialists would be unable to effect ETF transactions for their own accounts in a manner that would likely lead the market price in those securities, even if the transactions were effected on destabilizing ticks. The Exchange notes that the Commission has previously recognized this aspect of ETFs.[4]

[19] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Amendment No. 1 superseded the originally filed proposed rule change in its entirety.

[4] *See* Securities Exchange Act Release No. 49087 (January 15, 2004), 69 FR 3622 (January 26, 2004) (''[T]he Commission believes that because ETFs are priced derivatively, an Exchange specialist would not be able to manipulate the pricing of an ETF.'').