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October 4, 2005

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Katherine A. England
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Division of Market Regulation
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. SR-NASD-2003-141 – Response to Comments on Additional Mark-Up Policy For Transactions in Debt Securities

Dear Ms. England:

In SR-NASD-2003-141, NASD proposes a second interpretation to Rule 2440, IM-2440-2, to provide guidance on mark-ups in transactions in debt securities, except municipal securities ("Proposed Interpretation" or "Proposal"). NASD is responding to the five comment letters submitted to the Securities and Exchange Commission ("SEC" or "Commission") in response to the publication of the rule filing.[1]

The commenters raise several issues relating to the Proposed Interpretation. Many of the comments concern the core principle of the Proposed Interpretation -- the presumption that, except in certain circumstances, the prevailing market price ("PMP") is

[1] Securities Exchange Act Release No. 51338 (March 9, 2005), 70 Fed. Reg. 12764 (March 15, 2005). The comment period closed on April 5, 2005. The SEC received comment letters from: (1) Micah S. Green, President, and Michele C. David, Vice President and Assistant General Counsel, The Bond Market Association ("TBMA"), to Jonathan G. Katz ("Katz"), Secretary, SEC, dated April 5, 2005; (2) Paul Scheurer ("Scheurer"), to rule-comments@sec.gov, SEC, dated April 5, 2005; (3) William C. Caccamise, General Counsel and Managing Director, Banc of America Securities LLC ("BoA"), to Katz, Secretary, SEC, dated April 14, 2005; (4) Edward F. Greene, General Counsel, Corporate and Investment Banking, Global Corporate and Investment Banking Group, Citigroup, to Katz, Secretary, SEC, dated April 14, 2005; (5) John R. Gidman, Chair, Senior Executives Group, and David L. Murphy, Chair, Joint Buyside/Sellside Regulatory Developments, Senior Executives Group, The Asset Managers Forum, TBMA ("AMF-TBMA"), to Katz, Secretary, SEC, dated June 28, 2005; and (6) Debbie Cunningham, Chair, ASF Investors Committee, and Bianca Russo, Chair, ASF Regulatory Subcommittee, Asset Securitization Forum ("ASF-TBMA"), to Katz, Secretary, SEC, dated July 26, 2005.

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established by referring to the dealer's contemporaneous cost (or, in a mark-down, the dealer's contemporaneous proceeds).

As further discussed herein, with respect to the use of contemporaneous cost, commenters criticize the broad applicability of contemporaneous cost and assert that the Proposed Interpretation does not recognize that certain dealers, as market makers, should be permitted to receive the dealer's spread as compensation;[2] request more clarity on the meaning of "contemporaneous";[3] criticize the process to determine the PMP using a value *other than* contemporaneous cost (hereinafter, a "non-contemporaneous cost value"), including limiting a dealer to the three instances set forth in the Proposed Interpretation when a dealer may shift from the dealer's own contemporaneous cost to non-contemporaneous cost values in identifying the PMP (*i.e.*, significant changes in interest rates or the credit quality of the security, and Specified Institutional Trades (as defined in the Proposal));[4] criticize the Proposal's failure to consider the impact of small trades on price and the PMP;[5] criticize the limits on the ability to determine the PMP, in certain instances, by reference to certain other information and factors (*i.e.*, inter-dealer trades, trades with certain institutions, quotations, and information from transactions in similar securities), and economic models;[6] and criticize the scarcity of, or lack of access to, such other information.[7]

In other comments, as further detailed below, the commenters question the lack of uniformity in disseminated TRACE data;[8] question the applicability of the Proposed Interpretation to institutional customers;[9] criticize the Proposal's lack of guidance on

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2 *See generally* TBMA letter at pp. 7-17, BoA letter, Citigroup letter.

3 TBMA letter at p. 2, 18, 21; ASF-TBMA letter at p.2.

4 *See generally* TBMA letter, BoA letter, Citigroup letter, and ASF-TBMA letter.

As further addressed herein, a "Specified Institutional Trade" is defined as a dealer's contemporaneous trade with an institutional account with which the dealer regularly effects transactions in the same or a "similar" security, as defined in the Proposal, and in the case of a sale to such an account, the trade was executed at a price higher than the then PMP, and in the case of a purchase from such an account, the trade was executed at a price lower than the then PMP, and the execution price was away from the PMP because of the size and the risk of the transaction.

5 TBMA letter at pp. 31-32.

6 *See generally* TBMA letter, BoA letter, Citigroup letter, and ASF-TBMA letter.

7 *Id.*

8 TBMA letter at pp. 31-32.

9 *Id.* at pp. 30, 36, ASF-TBMA letter at p. 3.

riskless principal transactions;[10] suggest reviewing the yield to investor to determine if an investor received a fair price under Rule 2440;[11] and raise issues regarding recordkeeping, burdens and costs, including the impact to small and mid-size firms.[12]

I. Contemporaneous Cost

A. Presumption/Market Maker

The commenters, with one exception, criticize the Proposal's recognition of the fundamental principle of mark-up law: generally, contemporaneous cost, absent countervailing evidence, is considered the most accurate and reliable measure of the PMP. The commenters criticize the broad applicability of contemporaneous cost and assert that the Proposal does not recognize that dealers that take risk positions or allocate capital should be considered market makers and receive the dealer's spread as compensation.[13] In contrast, one commenter implicitly endorses the contemporaneous cost principle and suggests that a broker-dealer using a non-contemporaneous cost value to calculate its mark-up should be required to disclose that information to its customer on the confirmation.[14]

Commenters' statements that the Proposal ignores or does not properly recognize the role of dealers as market makers in the debt securities markets both misstate the Proposal and seek to undermine the application of prevailing law. The position that contemporaneous cost is presumed to be the best measure or proxy of the PMP of a security, including a debt security, is based upon NASD's mark-up policy and long-

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10 *Id.* at pp. 24-28, ASF-TBMA letter at p.2.

11 *Id.* at pp. 5-6, ASF-TBMA letter at p. 3.

12 *Id.* at pp. 34-37.

13 *Id.* at pp. 7-17, BoA letter, Citigroup letter. For example, one commenter argues that many dealers, whether by acting as block positioners, allocating capital, holding themselves out as being willing to buy or sell bonds for their own account, or taking positions, are performing market-making functions, and should be entitled to the dealer's spread. The commenter further suggests that NASD should adopt a safe harbor recognizing that dealers that devote substantial capital to providing market liquidity should qualify as market makers within the meaning of the Proposal. TBMA letter at p. 8.

14 Scheurer letter at p. 1.

standing precedent regarding fair mark-ups.[15] Moreover, the contemporaneous cost principle applies even *where the dealer has a position* in the security. In this regard, in *Naftalin,* the SEC affirmed an NASD decision, stating that the contemporaneous cost "rule" applied "whether or not a dealer has a position in the security, unless it can be shown that the dealer's contemporaneous cost is not representative of the market price prevailing at the time of his sales." Neither the Commission nor the NASD has ever changed this fundamental holding of mark-up law.[16]

In short, the commenters' argument that a dealer has an entitlement to additional compensation because of its allocation of capital or the positioning of a security at risk simply runs contrary to prevailing legal precedent. The argument appears to be premised on the view that such activity is sufficiently analogous to the function of acting as a market maker and the observation that mark-up law generally allows the market maker, subject to certain exceptions, to earn the difference between the bid and the offer without that amount counting towards the mark-up (mark-down). However, NASD clarified in the Proposal that, for purposes of the Proposal, the term "market maker" has the same meaning as defined in Section 3(a)(38) of the Securities Exchange Act of 1934 ("Exchange Act"). Consequently, the allocation of capital or risk positioning by itself

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15 *See, e.g., F.B. Horner & Associates v. SEC,* 994 F.2d 61, 63 (2d Cir. 1993); *Barnett v. S.E.C.,* 319 F.2d 340, 344 (8th Cir. 1963); *DMR Securities, Inc.,* 1980 SEC LEXIS 1071, *2 (July 21, 1980) ("We have repeatedly pointed out that, in the absence of countervailing evidence, a dealer's contemporaneous cost is the best evidence of current market price, (n.4 omitted) a standard that has been accorded judicial approval."); *Naftalin & Co.,* 1964 SEC LEXIS 459, *9 (January 10, 1964) ("The use of contemporaneous cost as an appropriate base upon which to compute mark-ups in retail transactions, 'absent countervailing evidence,' has frequently been recognized in our decisions [n.8 omitted] and has been affirmed by the courts.[n.9 omitted] This rule merely reflects a recognition of the fact that the prices paid for a security by a dealer in actual transactions closely related in time to his sales are normally a highly reliable indication of the prevailing market price.") *See also Charles Michael West,* 1979 SEC LEXIS 2415 (January 2, 1979).

16 *Naftalin,* 1964 SEC LEXIS 459, *9 (dealer was required to use its contemporaneous cost as the PMP when dealer held a position in equity securities). *See also First Pittsburgh Securities Corporation,* 1980 SEC LEXIS 1276, *18 (June 16, 1980) (SEC rejected registrant's argument that because it had "positions in the securities" it was entitled to a higher markup to compensate for its "risk position."); *Financial Estate Planning,* 1978 SEC LEXIS 1102, *5-6 (July 21, 1978) (SEC and NASD rejected argument that dealer was due additional markup compensation because dealer had an inventory in most of the securities in question, was in a risk position, and for some of the securities in question, had suffered unrealized losses on the inventories.); and *Waldron & Co., Inc.,* 1976 SEC LEXIS 665, *7 (October 6, 1976) ("the contemporaneous cost rule is applicable whether or not a dealer has a position in a security").

does not necessarily confer market-making status on a dealer because the law has additional requirements. NASD does not agree that the Proposal or the Exchange Act is flawed insofar as neither extends the benefits of market making to those who fail to meet the statutory definition. Moreover, NASD does not find a compelling public policy basis for extending all the privileges that attach to market making with the assumption of only part of the responsibilities mandated by law. Accordingly, as clarified in the Proposal, NASD adopts the term "market maker" as that term is defined in the Exchange Act for purposes of the Proposal, and will continue to apply the statutory definition of market maker without any broadening beyond the limits imposed by current law.[17]

B. Rule 2440 Requirements and Presumptions as to Prevailing Market Price

One commenter states that forcing dealers to rely on contemporaneous cost to the exclusion of other information is at odds with Rule 2440, which requires, among other things, a dealer to buy or sell at a price that is fair, 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 . . ."[18] This comment misapprehends the distinction between first determining the price from which a mark-up (mark-down) will be calculated and then determining the total price to the customer with the inclusion of that mark-up (mark-down) in determining the execution price. NASD believes that, in determining the price from which a mark-up (mark-down) is to be calculated, the general presumption favoring contemporaneous cost (as the PMP) is appropriate and entirely consistent with Rule 2440, because contemporaneous cost reflects the dealer's cost (proceeds) in a transaction negotiated in the current market at arms length. As we note above, identifying the PMP (in many cases, the contemporaneous cost) is only the first step in determining a dealer's mark-up (mark-down). After identifying the PMP, a dealer then considers whether the amount of the mark-up (mark-down) that the dealer might ordinarily charge for a transaction in a

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17 NASD continues to embrace the concept of market makers in the debt markets. NASD agrees with the commenters' assertions that "whether a dealer is acting as a market maker depends on the particular facts and circumstances" (*see, e.g., Adams Securities Inc.*, 1993 SEC LEXIS 506, *6 (March 9, 1993)) and recognizes legal precedent that has application in the current, decentralized, over-the-counter ("OTC") bond markets that may lack centralized markets and facilities. *See, e.g., Raymond James & Associates, Inc.*, 1997 SEC LEXIS 1581, *10 (Aug. 1, 1997) (Commission determined that Raymond James was a market maker in direct participation program securities in the OTC market); and *C.R.A. Realty Corporation v. Tri-South Investments*, 738 F. 2d 73 (2nd Cir. 1984) (for purposes of Section 16 of the Exchange Act, a broker-dealer was a market maker in convertible debentures (and the equity security to which debentures were convertible) in an OTC market in which there was no centralized mechanism for publishing bids and offers).

18 Citicorp letter at p. 2.

similar security or type of security should be increased or decreased based on the facts and circumstances of the transaction, including "market conditions with respect to such security at the time of the transaction," the expense involved and the additional factors listed in IM-2440(b)(1) through (7) (*i.e.*, the type of security involved, the availability of the security in the market, the price of the security, the amount of money involved in a transaction, disclosure, the pattern of mark-ups, and the nature of the member's business).

In addition, the Proposal accepts and allows for changes in current market conditions--significant changes in interest rates, credit quality (and as NASD proposes further herein, news affecting an issuer and the market's reaction to a small or large transaction) --- to be considered. These changes in "market condition" or the very small or large size of the dealer's contemporaneous trade may result in another price, rather than the dealer's "contemporaneous cost," serving as the PMP, consistent with the Proposal.

C. Defining Contemporaneous Cost

The commenters state that NASD should make clear that "contemporaneous cost" is not simply the bond's acquisition cost, define "contemporaneous cost," and provide guidance on how NASD will interpret the term.[19] One commenter suggests that NASD state, "there is no presumption that trades occurring within a particular period of time (or within a particular number of days) are 'contemporaneous.'"[20] The commenter argues that it is essential that contemporaneous cost not be determined by NASD solely by reference to an arbitrary, temporal standard, such as a fixed number of days within which one transaction is deemed to be "contemporaneous" with another.[21] The commenter also argues that equating a bond's "contemporaneous cost" with its PMP is based on an illogical assumption that a bond's value remains static in the absence of trading activity by *the dealer* executing the subject trade with the customer for which a mark-up (mark-down) must be calculated.[22] According to the commenter, at some point in time, a dealer's acquisition cost should be completely disregarded as relevant evidence of the PMP.[23]

The third paragraph of the Proposal makes it clear that a bond's acquisition cost may not be contemporaneous or contemporaneous cost may nevertheless be overridden where that cost is not an indicative price for certain reasons: "[C]ountervailing evidence . . . may be considered only where the dealer made no contemporaneous

19 TBMA letter at p. 2, 18, 21, ASF-TBMA letter at p. 2.

20 *Id.* at p. 21.

21 *Id.* at p. 22.

22 *Id.* at p. 22.

23 *Id.* at p. 23.

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."[24]

Whether a cost (or price) is contemporaneous to the transaction for which the mark-up (mark-down) is being calculated is a facts-and-circumstances test determined by the trading patterns of, and liquidity in, the subject security over time and during the period in question, and other factors. There are no absolute temporal standards used to determine if a transaction and the dealer's cost (proceeds) are "contemporaneous" to the subject transaction. For example, "contemporaneous cost" is not limited to same day costs. *See, e.g., First Pittsburgh Securities*, 1980 SEC LEXIS 1276, *16-17 (involving debt securities sales). However, as indicated in *DMR Securities, Inc.*, 1980 SEC LEXIS 1071 (July 21, 1980), a case also involving debt securities, "while contemporaneous cost is not limited to same-day cost, the prices a broker-dealer pays must nevertheless be 'closely related in time' to the retail sales in question to constitute evidence of the market price at the time of those sales."

Although the issue of determining "contemporaneous" is a facts-and-circumstances test, NASD proposes to amend the Proposal to provide additional guidance to members:

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

See also attached Exhibit A containing new text.

We disagree with the commenter that equating a bond's "contemporaneous cost" with its PMP is based on an illogical assumption that a bond's value remains static in the absence of trading activity by *the dealer* executing the subject trade with the customer for which a mark-up (mark-down) must be calculated. Under the Proposal, a transaction is either contemporaneous or it is not, but that determination does not necessarily turn on

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24 When a contemporaneous trade does not exist, the process that a dealer uses to determine the PMP is the same as that stated in the Proposal in the instances where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (proceeds) provide the best measure of the PMP. The Proposal has been amended to clarify this point in newly numbered paragraph (b)(5), as set forth in pertinent part in attached Exhibit A.

the absence of trading activity by the dealer. Moreover, as discussed above, a contemporaneous trade can be negated as the PMP where there is a significant change in interest rates or in the credit quality of the issuer, or, as proposed further herein, there is news affecting the issuer, or such contemporaneous trade is of such a size, either large or small, that it cannot be reasonably viewed as a transaction reflecting the market price for other transactions in that security. In sum, the dealer's transaction is used only when it is, under the facts and circumstances, contemporaneous and its pricing is not otherwise negated by the factors recognized by the Proposal. Contrary to any assertions of static pricing assumptions, NASD believes that the Proposal correctly allows for dynamic factors, including the lack of contemporaneousness, to inform the dealer as to the appropriate basis for determining the PMP.

II. Dealer's Ability to Use Non-Contemporaneous Cost Values Limited to Three Instances

The commenters criticize the process that they must take to determine the PMP using a non-contemporaneous cost value as too complex and unwieldy.[25] First, they criticize limiting a dealer to three instances where it may shift from the dealer's own contemporaneous cost to non-contemporaneous cost values in identifying PMP-- significant changes in interest rates or in the credit quality of the security, and Specified Institutional Trades.[26] Commenters argue that a dealer should be allowed to identify PMP using a non-contemporaneous cost value in other instances, including where there are "interest rate fluctuations"; "changes in credit quality"; "trading characteristics of particular debt securities"; "news affecting an issuer"; and/or "changes in valuation assumptions," and that use of these additional scenarios is very important when pricing a high yield security.[27] NASD addresses each of these five suggested instances, as well as the comments regarding large trades identified in the Proposal as Specified Institutional Trades, below.

"Interest Rate Fluctuations." NASD agrees with the comment that changes in interest rates triggered by events and market perceptions other than those that are particular to the specific bond may change the interest rate or yield of the specific bond, but believes that the *"interest rate fluctuations"* as described by the commenter are fully addressed by the criterion in the current Proposal regarding interest rates -- "interest rates ... of the security changed significantly after the dealer's contemporaneous trades."

"Changes in Credit Quality." NASD also believes that the scenario in the current Proposal -- "where . . . the credit quality of the security changed significantly after the dealer's contemporaneous trades" -- allows broker-dealers to appropriately consider the

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25 *See generally* TBMA letter, BoA letter, Citigroup letter, and AMF-TBMA letter.

26 TBMA letter at pp. 18-19; Citigroup letter at pp. 4-5. *See supra* note 4, for proposed definition of Specified Institutional Trade.

27 TBMA letter at pp. 19-21.

examples of "*changes in credit quality*" that the commenter discusses. NASD agrees that a variety of events and/or types of information, other than a formal announcement by a credit rating agency that a credit rating has been changed, may be indicative of changes in credit quality, and does not take the position that "credit quality" should be interpreted so narrowly as to be co-extensive with "credit rating."

"Trading Characteristics of Particular Debt Securities." One commenter states that a trader ought to be able to shift from the contemporaneous cost principle to a non-contemporaneous cost value when identifying the PMP of an illiquid security to consider "trading characteristics," such as illiquidity and the perceived willingness of current debt holders to continue to hold such debt. NASD, however, believes that information and perceptions about liquidity and illiquidity are or should have been factored into the market price reflected in the dealer's contemporaneous cost or proceeds.

"News Affecting An Issuer." NASD agrees with the commenter that certain examples under the category, "news affecting an issuer," such as news of legislation that may affect specific issuers or industry sectors, are less clearly categorized as either a significant change in interest rate or in the credit quality of the security, but may cause price shifts in a debt security invalidating "contemporaneous cost" as a reliable and accurate measure of PMP.[28] In such cases, NASD agrees that the dealer should be permitted to look to non-contemporaneous cost values (in the order set forth in the

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28 Examples of "news affecting an issuer" that may not be included in the two existing categories include: news about pending or contemplated legislation that may affect issuers or industry sectors, particularly for bonds trading at distressed levels, such as legislative developments affecting asbestos claims and pension regulation. TBMA letter at pp. 20-21. The commenter states that prices may change without "any fundamental change in the credit quality of the company."

NASD agrees that the news developments may change the prices of bonds although the news may not apply specifically to the issuer, or apply only because all companies within an industry sector appear to be impacted, although by varying amounts. NASD believes that an assessment of a company's *creditworthiness* over time includes not only the company's governance, management of existing debt and other obligations and its debt ratios, but also must include impacts or perceived impacts on the company from external forces (*e.g.*, expropriation of an operating facility or other assets located in a foreign country, which may or may not be a significant revenue stream for the repayment of one or more issues of corporate debt, actual litigation or possibility of such against either the company or companies involved in the same industry and/or engaged in the same practices, any legislative action that would appear to create a more favorable or less favorable economic climate in which the company may operate in the future, etc.). NASD believes that including a reference to news affecting an issuer in the Proposal's criteria may provide more clarity for broker-dealers trying to determine if they fall within an appropriate criterion to refer to a non-contemporaneous cost value to identify PMP.

Proposal) to establish PMP. Accordingly, NASD proposes to amend the Proposal as set forth in attached Exhibit A to add "news affecting an issuer" to the possible instances when a shift from contemporaneous cost may be appropriate.

"Changes in Valuation Assumptions." One commenter argues that the occurrence of "changes in valuation assumptions" by the dealer should be a further justification for the dealer to consider a non-contemporaneous cost value to identify PMP.[29] NASD disagrees. If a dealer has a contemporaneous purchase transaction in the security, the dealer's prior valuation assumptions will be assumed to be valid for a contemporaneous resale. This is not a restriction on the dealer's ability to change valuation assumptions as facts and news develop regarding an issuer, as discussed above.

Large Trades/Specified Institutional Trades. With respect to Specified Institutional Trades, the commenters agree with NASD's recognition that a bond's contemporaneous cost may not accurately reflect the PMP in the case of certain large trades, but criticize the limits on the use and the definition of a Specified Institutional Trade, and suggest that NASD expand the circumstances in which the dealer may ignore such trades when establishing PMP.[30] Commenters are particularly critical of the requirement to identify one or more contemporaneous inter-dealer trades in the same security, noting that inter-dealer trades occur less frequently in the fixed income markets than in the equity markets, and even less frequently in illiquid sectors of the debt markets (*e.g.*, "credit-sensitive" or distressed debt securities, and other bonds that trade infrequently), *and* that the specific evidentiary requirement has no bearing on whether the transaction price is or is not indicative of PMP.[31] One commenter suggests that NASD eliminate the requirement that the institutional counter-party in a Specified Institutional Trade be "an institutional account with which the dealer regularly effects transactions in the same or a 'similar' security."[32] In addition, a commenter criticized the Proposal for

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29 The commenter's examples of instances where the dealer might change its internal assessment of the appropriate price of the security include its changing assessment of valuations of an issuer's trade receivables or the assets underlying the structured security, the marketability of major assets, the probability of a sale of the company and the likelihood of substantial changes to the issuer's capital structure (reorganization, restructuring), the issuer's ability to improve its cashflow, or changing perceptions of the litigation rights associated with a particular bond class (*e.g.*, the ability of the holder to participate on a creditors' committee), the assets underlying the structured security due to changes in prepayment trends, collectibility and default rates. TBMA letter at p. 20.

30 TBMA letter at p. 29; Citigroup letter at p. 5.

31 TBMA letter at p. 29; Citigroup letter at p. 5. One commenter notes that NASD previously proposed a version of the Interpretation explicitly recognizing that inter-dealer trades may not exist or are rare for inactively traded securities. Citigroup letter at p. 5.

32 TBMA letter at pp. 29-30.

failing to acknowledge that certain small trades, like certain large trades, may occur at prices away from the PMP, and not including a comparable provision that would permit a broker-dealer to disregard a contemporaneous small trade for purposes of identifying the PMP.[33]

NASD has carefully considered the commenters concerns and proposes to amend the Proposal as follows to take into account the impact that the size of a contemporaneous trade, whether large or small, may have on the pricing of that transaction, and to delete the specific references to Specified Institutional Trades:

> 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, <u>or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the bond,</u> after the dealer's contemporaneous [trades]<u>transactions</u>, or <u>(ii) because the size of such transaction, either large or small, caused the transaction to be executed at a price away from the prevailing market price of the same security, as evidenced by contemporaneous transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities.</u> [(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.]

33 TBMA letter at pp. 31-32.

See also attached Exhibit A containing revised text.

III. Factors In Determining PMP Other Than Contemporaneous Cost

Where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's own contemporaneous cost (proceeds) provide the best measure of the PMP, or where interest rates or credit quality of the security changed significantly (or, as proposed, where news was issued, or where the large or small size of the contemporaneous trade negates the value of the contemporaneous trade as PMP), the dealer must follow a process for determining PMP, considering factors in the appropriate order.

Initially a dealer must look to three factors or measures in the order they are presented (the "Hierarchy") to determine PMP. The most important factor in the Hierarchy is the pricing of any contemporaneous inter-dealer transactions in the same security. In the absence of inter-dealer transactions, the second factor a dealer must consider is the 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. If contemporaneous inter-dealer trades or dealer-institutional trades in the same security are not available, a dealer must look to the third factor, which may be applied only to actively traded securities. Here, a dealer is required to look to contemporaneous bid (offer) quotations for the security in question for proof of the PMP if such quotations are made through an inter-dealer mechanism through which transactions generally occur at the displayed quotations. If none of the three factors in the Hierarchy is available, the dealer may then take into consideration a non-exclusive list of "four factors" in trying to establish the PMP using a measure other than the dealer's contemporaneous cost (proceeds), which address the use of "similar" securities in establishing the PMP.

In considering these factors, commenters raised several issues about the proposed limits on their use, and the scarcity of, or dealer's lack of access to, such information.[34] For example, commenters argue that contemporaneous inter-dealer trades often do not exist, especially when reviewing pricing information for an inactively traded security, and requiring that dealers look first to such trades does not provide dealers pricing

34 TBMA letter at pp. 3-4, 19, 24; BoA letter at pp. 5-6; and Citigroup letter at pp. 5-6.

guidance. Commenters argue that the Hierarchy and post-Hierarchy factors that may be reviewed provide little pricing guidance for a dealer in illiquid debt securities.[35]

NASD addresses the comments regarding the Hierarchy and the four factors below.

A. Hierarchy

Inter-Dealer Trades. In the Hierarchy, the Proposal requires that a dealer look first to pricing from other inter-dealer trades in the same security when the dealer seeks to move from contemporaneous cost. As noted above, commenters criticize this requirement, citing the lack of such trades. In addition, they note that a dealer currently may not be able to identify an inter-dealer trade from the disseminated data. NASD requires that dealers look first to inter-dealer pricing because such trades generally are executed at prices negotiated between market professionals at arms-length and therefore are highly reliable evidence of the PMP. The evidentiary weight the Proposal attributes to such trades is supported by the Commission's longstanding mark-up analysis.[36] NASD recognizes that inter-dealer trades do not exist in certain debt securities or occur relatively rarely, and for this reason, inter-dealer pricing information is the *first* category of "other information" that a dealer reviews to identify the PMP. In addition, in response to comments that dealers do not have access to *inter-dealer* trade pricing information, NASD is evaluating enhancing the quality of disseminated TRACE information to show, for each trade, whether the trade is inter-dealer or customer, as is now indicated in real-time disseminated municipal securities transactions data.

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35 BoA letter at pp. 5-6; TBMA letter at p. 3. One commenter provided as an example, the following: a dealer attempting to determine the PMP of an equity tranche of a collateralized debt obligation ("CDO") held in inventory would face the following obstacles: (1) a presumption that its contemporaneous cost was the PMP, notwithstanding that it had acquired the securities days or weeks prior to the transaction; (2) provided the dealer had no contemporaneous trade, an instruction to look first to inter-dealer trades in the same security, notwithstanding the complete absence of an inter-dealer market; (3) an instruction to look next to contemporaneous trades with institutional customers with which the dealer regularly effects trades in the same security, notwithstanding that no contemporaneous trades would exist and, even if they did, the dealer would have no way of knowing the identity of the institution whose trade was reported; (4) an instruction to look next to bid or offer quotations, but only if the security is "actively traded," which would be wholly inapplicable; and (5) an instruction to look next to a variety of equally inapposite factors relating to (a) similar securities (defined to exclude most asset-backed securities, CDOs, and structured securities); (b) contemporaneous transactions; and (c) "validated" inter-dealer quotations. BoA letter at pp. 5-6.

36 *See* Securities Exchange Act Release No. 24368 (April 21, 1987), 52 Fed. Reg. 15575 (April 29, 1987) ("Zero-Coupon Securities Notice").

Dealer-Institutional Customer Transactions. When inter-dealer transactions are not available, a dealer must take into consideration in establishing the PMP the 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. NASD developed this factor, recognizing that inter-dealer trades may not occur frequently in certain types of debt securities and that, instead, certain institutional counter-parties play a significant economic role in the market of a particular debt security. Market participants and industry interest groups have argued that dealer-institutional counter-party trading occurs much more frequently than inter-dealer trading in most debt market segments; NASD believes that such trade pricing information will be a valuable and useful source of information to dealers in determining the PMP. In addition, dealers that trade the market segment should have some level of access to this information.

Quotations. When neither inter-dealer trades nor the previously defined dealer-institutional trade information is available, in actively traded securities, dealers are required to look to a third category of "other information" -- contemporaneous bid (offer) quotations in the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotation. The evidentiary weight that NASD attributes to quotations, as qualified above, is also supported by long-standing Commission mark-up analysis,[37] and although such information may not be available currently in many sectors of the debt markets, NASD expects dealers to look to the information *when it is available.*[38]

B. <u>Four Factors Involving "Similar Securities"</u>

As noted above, the Proposal also sets forth four additional categories of "other information" ("four factors") that a dealer considers to identify the PMP when the dealer does not believe that contemporaneous cost is the correct measure of the PMP and the

37 *See* Zero-Coupon Securities Notice.

38 Market facilities and structures in the debt markets are evolving rapidly, and although quotation information described above may not exist or may not currently be accessible in many debt sectors, the Proposal recognizes the validity of qualified quotations *when they exist* and requires broker-dealers to refer to such quotation information as it becomes available.

three factors in the Hierarchy do not yield current pricing information.[39] These four factors allow a dealer to review multiple trades in multiple securities if they are sufficiently "similar" to the subject security and the trades to be compared share common characteristics (*e.g.*, are of similar size, are on the same side of the market, etc.). Each factor incorporates pricing information that dealers generally will have some level of knowledge of and access to in the debt market segments in which they trade. Finally, the dealer is not required to apply the four factors in a particular order. The dealer's obligation is to identify the information that will, in its professional view, provide the dealer the most accurate PMP of the subject security, by reviewing the information available to it from the executed transactions (or the quotations) in one or more similar securities. These factors provide dealers in many instances with multiple sources of pricing information to identify PMP.

Many aspects of debt securities dealing and trading require a professional, whether a dealer or an institutional customer, to identify and understand the degree of similarity among certain debt securities within a segment of the debt market. Dealers routinely engage in this analysis for their own trading and in trading with or for a customer, and have multiple methods and sources of information about "similar" securities.[40] Thus, NASD believes that the four factors provide broker-dealers with varied, multiple additional sources of pricing information to review when a dealer is convinced that the dealer's cost is not the PMP, and needs to refer to factors incorporating "similar" securities pricing information.

C. Economic Models

If information concerning the PMP of the subject security cannot be obtained by applying any of the Hierarchy factors or the four factors, a member may consider as a factor in determining PMP the prices or yields derived from economic models that take into account measures such as credit quality, interest rates, industry sector, time to

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39 The four factors proposed are: (1) prices of contemporaneous inter-dealer transactions in a "similar" security, 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; (2) yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities; (3) yields calculated from prices of contemporaneous purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities; and (4) yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in similar securities.

40 Certain electronic systems or trading screens have developed programs to identify similar securities. For example, price, interest rate, yield and maturity -- four significant characteristics -- may be identified to search instantaneously for similar securities in MarketAxess. A professional market participant then may be able to further cull the group of similar securities to those that are most "similar" to determine the PMP for mark-up purposes.

maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions.

Commenters raised several concerns on the proposed use of economic models. For instance, one commenter criticized limiting the use of economic models to those debt securities for which there are no contemporaneous trades in the same security, no inter-dealer trades, and no similar securities, and instead argued that models should be permitted as one factor a dealer may review to determine the PMP for debt securities generally, especially illiquid securities and structured securities.[41] In this regard, the commenter noted that in illiquid debt securities, such as high-yield, distressed, emerging market and many types of structured debt securities (e.g., asset-backed securities, mortgage-backed securities, collateralized debt obligation securities), pricing tends to be model-driven.[42]

Other commenters also stated that the Proposal overly restricts the use of economic models.[43] One commenter criticized limiting models to only those instances occasions where the pre-condition of interest rate/credit quality changes had been met, and at the same time noted that it is not clear that such models could provide clarity in establishing a specific PMP at a defined point in time, particularly in the face of a strong presumption in favor of the dealer's cost.[44] Other commenters argued that NASD should make clear that a dealer entitled to rely on an economic model to determine the PMP may use that price, rather than its "contemporaneous cost," to price a close-in-time transaction in that security.[45] Finally, commenters raised issues about the attendant recordkeeping, noting that it was not clear what types of records (and what form) must be created for the dealer to overcome the presumption of contemporaneous cost, and that dealers overwhelmingly do not have systems in place to currently capture and retain some of the information required, such as the data inputs and outputs by economic models.[46]

NASD's inclusion of economic modeling in the Proposal is in direct response to the concerns expressed by members that deal in certain securities, such as complex, structured or unique securities, high-yield and/or distressed securities and illiquid securities. Members indicated that the prior versions of the Proposal and an earlier debt mark-up proposal did not provide dealers with any guidance or method to determine the PMP in such securities (*i.e.*, complex, unique, distressed, or illiquid securities having no "similar" securities). NASD recognizes that these securities are those where very often

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41 TBMA letter at pp. 23-24.

42 *Id.* at p.3.

43 BoA letter at p. 7, TBMA letter at pp. 8, 23, and Citigroup letter at p. 5.

44 Citigroup letter at p. 5.

45 TBMA letter at pp. 23-24.

46 Citigroup letter at p. 6; BoA letter at p. 6; and TBMA letter at pp. 24, 36-37.

none of the other information in the Proposal could be applied; accordingly, the Proposal provides dealers the flexibility needed to identify the PMP when such other information *is not* available. NASD, however, correctly limits the use of economic modeling to those transactions and securities where "other information" fails to yield accurate, current pricing data to identify the PMP. NASD limits the use of economic models to those situations where the other data recognized in the Proposal is not applicable because of the inherent potential for conflicts and abuse that arise from the domination of pricing determinations based on a broker-dealer's own proprietary models. These factors also, in part, dictate the requirement to maintain information about the inputs to and output from the economic model so that the pricing determinations can be susceptible to meaningful review by NASD should transactions warrant examination.

IV. Fee-Based Accounts and Disseminated TRACE Pricing Data

A commenter notes that the Proposal, with its presumption favoring contemporaneous cost, "fails to take into account the distortive affect that non-traditional fee-based brokerage arrangements have on bond prices" that are disseminated in TRACE, because, the commenter argues, brokerage firms have increasing numbers of fee-based brokerage arrangements with retail customers, and TRACE price information disseminated on transactions executed for such accounts does not include transaction-specific compensation (either a mark-up or a commission). The commenter states that the fairness of an imbedded mark-up in one trade should not be assessed by a comparison to a price, albeit "contemporaneous," that reflects no such mark-up or mark-down.[47]

NASD notes that generally retail transaction prices include mark-ups (or mark-downs or commissions), but that some do not, including those executed for fee-based accounts. The commenter's argument that some TRACE prices have smaller or no mark-ups or commissions (or mark-downs) than other TRACE trades prices and would have a "distortive" effect on bond prices is not persuasive. As stated above, a dealer will generally look to the dealer's own contemporaneous cost in determining the PMP. When a dealer determines that the dealer's contemporaneous cost is not the appropriate measure of the PMP, or the dealer's trade is no longer contemporaneous, there are several additional pieces of pricing information that the dealer must look to in identifying the PMP (*e.g.,* inter-dealer pricing of the same security; dealer-institutional pricing of the same security; quotations; then pricing in similar securities). A dealer analyzing the pricing information in manner and order required under the Proposal runs an extremely remote and largely theoretical risk -- that the dealer will arrive at and consider a *single* retail transaction that was done for a fee-based account and does not include any mark-up (mark-down) or additional charges. The low probability of an anomalous outcome does not, in our view, call into question the otherwise overarching reasonableness of the regulatory scheme in the Proposal.

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47 TBMA letter at pp. 32-33. In transactions for fee-based customer accounts, the reported prices may appear *lower* in member sales to customers and *higher* in member purchases from customers.

V. Riskless Principal Transactions

A commenter states that NASD should define riskless principal transactions in the Proposal, clarify that a riskless principal transaction requires a dealer to have a firm order in hand for both the purchase and sale transactions, and also clarify if such trades are to be treated differently under the Proposal.[48] The commenter argues that NASD should acknowledge that many considerations bear on the fairness of a mark-up in such transactions, including specialized services offered by a dealer as well as risks other than loss of capital, such as settlement risks.[49] Thus, NASD should agree that, in such circumstances, a mark-up in excess of five percent may be justified, or clarify in the Proposal that "mark-ups on riskless principal transactions may not exceed five percent absent exceptional circumstances."[50]

In response to the commenter's request for guidance clarifying when, if ever, a dealer may consider the special services provided or special risks incurred when pricing a riskless principal transaction (*e.g.*, providing specialized research, incurring settlement risk for an emerging market security), NASD notes that the commenter appears to confuse the identification of the PMP with the percentage of mark-up that is applied to the PMP to calculate a mark-up. A dealer may consider special efforts, expertise, or extraordinary risks in determining the appropriate total amount of mark-up in a riskless principal transaction, as well as in a principal transaction or an agency transaction. Whether a dealer provides special services or incurs special risks is a facts-and-circumstances test.

NASD further notes that while the Proposal does not define or specifically address riskless principal transactions, issues regarding riskless principal transactions should not be used to delay consideration and approval of the basic principles set forth in the Proposal.

VI. Yield to Customer.

Commenters suggest that NASD should consider adopting the approach of the Municipal Securities Rulemaking Board (MSRB) in determining whether a price to a customer, including any mark-up or mark-down, is fair.[51] In particular, although MSRB

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48 TBMA letter at pp. 4-5, 24-25. *See also* ASF-TBMA letter at p. 2.

49 TBMA letter at pp. 4-5, 27-28.

50 TBMA letter at pp. 4-5, 25-26.

51 TBMA letter at pp. 5-6, BoA letter at p. 2, AMF-TBMA letter at p. 2, and ASF-TBMA letter at p. 3.

Rule G-30 lists a number of factors that must be analyzed together to determine if a customer receives a fair price, in various statements the MSRB has focused on yield.[52]

In contrast to the MSRB approach, NASD considers a variety of factors in determine fair pricing, and such factors do not have different evidentiary weighting. In this regard, NASD's approach to mark-up regulation and analysis of whether a mark-up or mark-down results in a fair and reasonable price to a customer follows, in many key respects, the analytical approach of the Commission. NASD further notes that this comment goes beyond the scope of the Proposal. There is no fundamental retooling of NASD's longstanding policy under IM-2440 that logically invites the comment to adopt another regulator's scheme. The Proposal does not seek to redefine the factors that dictate fair pricing in the debt market. Rather, it merely seeks to add clarity by restating the predicate requirement of establishing the basis of PMP from which the fairness of mark-up pricing can then be determined under existing guidance and the use of similar securities.

VII. Institutional Customers

One commenter suggests that NASD develop a framework for mark-up regulation that acknowledges the sophistication and experience of certain institutional customers, and limits dealers' obligations to provide a fair price to such customers. The commenter notes that NASD limits the scope of the protections of Rule 2310, the suitability rule, when a dealer makes a recommendation to certain institutional customers.[53] According to the commenter, if such customers have the capacity to evaluate investment risk independently and exercise independent judgment in evaluating recommendations in

52 See "MSRB Report on Pricing," September 26, 1980. In 1980, the MSRB stated: "Of the many possible relevant factors, the Board continues to be firmly of the view that the resulting yield to a customer is the most important one in determining the fairness and reasonableness of the price in any given transaction. Such yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market." *See also* MSRB Notice 2004-3 (January 26, 2004), "Review of Dealer Pricing Responsibilities."

In MSRB Rule G-30(a), relevant factors used to determine if the aggregate transaction price (including any mark-down or mark-up) to the customer is fair and reasonable, are: "the best judgment of the broker, dealer, or municipal securities dealer as to the fair market value of the securities at the time of the transaction and of any securities exchanged or traded in connection with the transaction, the expense involved in effecting the transaction, the fact that the broker, dealer, or municipal securities dealer is entitled to a profit, and the total dollar amount of the transaction."

53 TBMA letter at pp. 30-31. *See* NASD IM-2310-3, Suitability Obligations to Institutional Customers.

specific securities transactions, it is logical that certain institutions should also be able to assess fair pricing, at least in certain instances, and not need the protections afforded by Rule 2440 and interpretations thereto.[54]

NASD declines to amend the Proposal at this time to exclude certain institutions from the protections of the regulatory scheme for mark-ups. First, although transparency has improved significantly in the corporate bond market, in most sectors pricing information is not transparent. In addition, most debt securities transactions continue to be executed by dealers as principal, a type of transaction that enables dealers to shield from their customers the dealer's compensation and profits. This prevents customers, even the most knowledgeable institutional customers, from comparing compensation and fees charged by various dealers. The lack of information regarding mark-ups distinguishes the regulatory scheme for mark-ups from the various regulatory approaches to suitability and institutional customers.[55]

VIII. Cost Burden; Burdens on Small Businesses

One commenter argues that the Proposal unfairly shifts the burden to a dealer when the dealer shifts from contemporaneous cost to another measure to identify PMP, requiring the dealer to provide specific evidence,[56] that NASD failed to identify what types of evidence must the dealer create and maintain, and in what form, for the dealer to be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost provides the best measure of the PMP,[57] and that these requirements impose a number of new procedural and recordkeeping obligations, resulting in costs that far outweigh the generalized asserted benefits.[58] Further, the commenter argues that the Proposal was filed without reference to studies or assessments that would enable a meaningful review of the burden and costs of the Proposal.[59] Finally, the commenter suggests that the Proposal's requirement to use contemporaneous cost may have a significant economic impact on mid-size or small firms dealing exclusively in

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54 TBMA letter at p. 30, ASF-TBMA letter at p. 3.

55 *See, e.g.*, NASD IM-2310-3, Suitability Obligations to Institutional Customers; MSRB Rule G-19, Suitability of Recommendations and Transactions; Discretionary Accounts; and MSRB Rule G-17 Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (April 30, 2002).

56 TBMA letter at p. 34.

57 *Id.* at p. 37.

58 *Id.* at p. 35.

59 *Id.*

bonds and offering specialized bond services, and that the Proposal should not be approved without further study.[60]

NASD has assessed the burdens and costs to investors from excessive mark-ups in debt securities transactions, the costs to the market and investors caused by regulatory uncertainty of a long-pending debt mark-up interpretation, and finally, the costs to the market by the development of policy by litigation and disciplinary proceedings against the cost burdens highlighted by the commenters. For clarity and the ease of member firms that do not have large legal and compliance departments, such as small firms, NASD believes that clearly stating the current, legally binding central principle regarding contemporaneous cost that is of general applicability to all transactions in debt securities will reduce compliance costs, other compliance burdens, questions, and missteps. If this principle is not published in NASD's rules, NASD will continue to enforce the principle, when violated, through disciplinary proceedings. In response to comments regarding the application of contemporaneous cost, as stated earlier, the core principle of contemporaneous cost is taken from existing legal and regulatory precedent. The argument that the Proposal creates new information and record-keeping costs and burdens is erroneous; in fact, such requirements exist today.

In other ways, the Proposal will ease regulatory burdens and make clearer certain policies applicable to mark-ups in debt transactions. For example, the ability of dealers, in certain circumstances, to rely on pricing from institutional trades provides additional regulatory flexibility, and the proposed use of similar securities and guidance concerning what constitutes a similar security provide more regulatory flexibility than current law and additional clarity.

NASD strongly believes that a clear regulatory scheme set forth in NASD rules and interpretations is a regulatory approach that is the least costly and burdensome to all firms, and particularly to small firms. In addition, in the Proposal, NASD is seeking to incorporate in a rule current mark-up regulation and to broaden the regulatory scheme to provide additional flexibility. Thus, to some extent, the costs of the Proposal should be less than or equal to the current costs of compliance with current mark-up regulation. If a firm wishes to take advantage of the additional flexibility, the firm's decision to do so would likely include a cost/benefit analysis and a judgment that the costs associated with retaining information required for evidentiary purposes are outweighed by the benefits afforded by additional flexibility.

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60 *Id.* at p. 36. The commenter also states that several other issues, all previously discussed above, be studied and further assessed before the Proposal is approved. *Id.* at pp. 36-37. NASD notes that the industry and NASD have been engaged in a constructive dialogue regarding debt mark-up guidance and interpretive issues for several years. *See, e.g.,* NASD Solicits Member Comments On The Application of The NASD Mark-Up Policy To Transactions in Government and Other Debt Securities, NASD Notice to Members 94-62 (August 1994).

If you have any questions, please contact me at (202) 728-8985 or sharon.zackula@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Sharon K. Zackula

Sharon K. Zackula

cc: Catherine McGuire
Richard Strasser
Andrew Shipe

Exhibit A

New text is underlined; deleted text is in brackets.

1. Amendment clarifying the process to determine the PMP when a contemporaneous trade does not exist. (*See* discussion on page 7, n. 23.)

    In instances [other than those pertaining to a Specified Institutional Trade,] where the dealer has established that the dealer's cost (proceeds) are no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price . . ..

2. Amendment regarding contemporaneous cost. (*See* discussion on page 7-8.)

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

3. Amendments regarding news affecting an issuer and size of trade/Specified Institutional Trade. (*See* discussions on pages 9-10 and 11-12.)

    A dealer may be able to show that its contemporaneous cost or proceeds are not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates or the credit quality of the security changed significantly, or news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the bond, after the dealer's contemporaneous [trades]transactions, or (ii) because the size of such transaction, either large or small, caused the transaction to be executed at a price away from the prevailing market price of the same security, as evidenced by contemporaneous transactions in the same security, or, in the absence of such transactions, contemporaneous transactions in similar securities. [(ii) the dealer's contemporaneous trade was with an institutional account with which the dealer regularly effects transactions in the same or a "similar" security, as defined below, and in the case of a sale to such account, was executed at a price higher than the then prevailing market price, or, in the case of a purchase from such account, was executed at a price lower than the then prevailing market price, and the execution price was away from the prevailing market price because of the size and risk of the transaction (a "Specified Institutional Trade"). In the case of a Specified Institutional Trade, when a dealer seeks to overcome the presumption that the dealer's contemporaneous cost or proceeds provide the best measure of the prevailing market price, the dealer must provide evidence of the then prevailing market price by referring exclusively to inter-dealer trades in the same security executed contemporaneously with the dealer's Specified Institutional Trade.]