



Securities Industry Association

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March 8, 2002

Barbara Z. Sweeney  
Office of the Corporate Secretary  
National Association of Securities Dealers, Inc.  
1735 K Street, NW  
Washington, DC 20006-1500

***Re: Comments on Special NASD Notice to Members 02-09***

Dear Ms. Sweeney,

The Securities Industry Association (“SIA”)<sup>1</sup> appreciates the opportunity to comment on Special NASD Notice to Members 02-09 (“NTM 02-09”). This letter expresses the views of the SIA Operations, Trading, and Self-Regulation and Supervisory Practices Committees (the “Committees”).

SIA is a strong supporter of self-regulation and recognizes the important role played by the NASD in that structure. SIA also supports member firm funding of self-regulatory activities and stands ready to assist in determining how that funding should be shared by member firms in an equitable way and administered in an efficient and accurate reporting and collection system.

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<sup>1</sup> The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 80 million investors directly and indirectly through corporate, thrift, and pension plans, and generates more than \$300 billion of revenues yearly in the U.S. economy. U.S. securities firms employ more than 600,000 individuals. (More information about SIA is available on its home page: <http://www.sia.com>.)

The Committees appreciate this opportunity to comment on NTM 02-09, but have found the process somewhat challenging because the notice does not include a clear presentation of 1) the financial impact of the proposal compared with the status quo, including a discussion of the assumptions used in determining that impact, and 2) the administrative procedures under which the new fees are to be calculated and collected. SIA believes that any fee proposal put forward by a self-regulatory organization for comment by its members should include such a presentation. Without the information this presentation would provide, firms are unable to determine the rationale for the changes proposed in NTM 02-09. The Committees put forward in the body of this letter a number of questions that they would like to discuss prior to implementation of the proposal. SIA would appreciate an opportunity to discuss with the NASD the structure of the NASD's regulatory revenue assessment and collection methods and the NASD's allocation of that revenue to regulatory activities.

Member firms have concerns about the NASD's existing billing methods and the impact the changes proposed in NTM 02-09 would have on member firms. A review of the proposals outlined in NTM 02-09 and of the current application of Section 8 of Schedule A to the NASD By-Laws – which defines the scope of application of NASD regulatory fees (“Section 8 Fees”) – has highlighted a variety of issues with the NASD's fee assessment and collection methods. The Committees note, for example, that they have experienced serious ongoing difficulties with the NASD's collection of the fees authorized under Section 31 of the Securities Exchange Act of 1934. These difficulties are under discussion with the NASD separately, but firms feel strongly that the administrative process for any new fees be clearly defined and agreed upon prior to implementation. In addition, member firms express concern that the imposition of the changes proposed in NTM 02-09 could increase regulatory fee costs and operational burdens to firms.

Therefore, it would be inappropriate for the NASD to impose the changes announced in NTM 02-09 before 1) providing further information regarding the impact of the changes contemplated in NTM 02-09; 2) resolving the issues in connection with the NASD's existing fee assessment and collection methods; and 3) addressing member firm concerns



with NTM 02-09 by (i) addressing any concerns that may arise as to member firms being charged a regulatory fee by both the NASD and by the market on which they execute transactions and (ii) by taking action to eliminate any additional operational burdens the changes proposed in NTM 02-09 would place on firms.

Although the Committees recognize that the proposed changes need to be filed with the SEC, we believe that, as a fee filing, it would most likely be immediately effective upon filing. Therefore, the Committees believe these concerns must be addressed prior to filing.

#### I. SUMMARY OF NTM 02-09

NTM 02-09 states that:

The amendments would permit NASD to continue to assess fees on members, either directly for self-clearing members or through clearing firms, for transactions in:

- (1) any security traded on Nasdaq or a facility of Nasdaq,
- (2) any Nasdaq-listed security, regardless of where the transaction takes place, and
- (3) any other equity security occurring otherwise than on an exchange.

According to NTM 02-09, the proposed changes are designed to preserve the NASD's existing revenue stream despite developments in market structure. Major changes proposed by NTM 02-09 are as follows:

**A. Fees would be assessed on any trade in a Nasdaq security, including those that are not reported through the Automated Confirmation Transaction ("ACT") System.** Currently, the fee is only assessed on trades reported through ACT. Under the new rules, however, Nasdaq trades executed on and/or reported through other venues would be assessed Section 8 Fees. For example, trades reported by the Island ECN, Inc. to

the Cincinnati Stock Exchange would be assessed Section 8 Fees. The NASD has not indicated how those trades will be identified.

**B. Fees will be assessed on internalized trades.** Section 8 of Schedule A to the NASD By-Laws indicates that fees are not assessed on internalized trades. The current scope of the regulatory fee is described as:

(1) NASD fee on cleared transactions. Each member shall be assessed a transaction charge of \$.0625 per 1,000 shares, with a minimum charge per side of \$.025 and a maximum charge per side of \$.46875 for each over-the-counter transaction **with another member** [emphasis added] of the Association reportable through ACT in which the member acts either as an agent or a principal for the purchase and/or sale of equity securities.

## II. ISSUES OF CONCERN

SIA member firms' concerns fall into three broad categories. First, member firms do not believe the NASD has provided adequate information regarding the processes associated with its regulatory revenues or a sufficient rationale for the changes in the assessment and collection of those revenues. Second, examination of the process surrounding the assessment and collection of Section 8 Fees has highlighted a variety of issues with current NASD fee collection methods. Third, member firms have expressed concerns with the impact the changes proposed in NTM 02-09 could have on firms in that firms may pay regulatory fees twice and/or incur additional operational expenses.

### **A. Concerns with the NASD's Fee Proposal Presentation**

The Committees believe that the NASD has not provided sufficient information in its NTM 02-09, and therefore pose the following questions:

1. NASD currently receives at least two revenue streams to fund its regulatory activities – a gross income fee and a transaction (Section 8 ) fee.
  - i. Why are there two funding streams and which regulatory activities are funded by each stream?
  - ii. What are the revenue streams projected to be under the NASD proposal compared with the current fee schedules and what assumptions have been made for member firm revenues and transaction volumes in order to arrive at those projections?
  - iii. How does the NASD propose to address over or under funding in the event that member firm revenues or transaction volumes materially exceed or fall short of its projections?
2. With the impending separation of NASD and Nasdaq, member firms are unclear about the proposed regulatory fees in the broader context:
  - i. Does the separation of Nasdaq mean that the NASD's regulatory activities decrease?
  - ii. Does Nasdaq contemplate proposing its own regulatory fee?
  - iii. What will be the combined total of NASD and Nasdaq fees under the proposals compared with the status quo?

The Committees believe that responses to the questions above are necessary components in the development of a compelling rationale for the changes in the scope of the assessment of Section 8 Fees as proposed in NTM 02-09.

## **B. Issues with NASD's Fee Assessment and Collection Methods**

1. Clearing firms are billed in aggregate. The NASD issues monthly, aggregate invoices to clearing firms for Section 8 Fees. The NASD invoices do not provide detail, such as the aggregate fees accrued per correspondent (when a clearing firm has multiple correspondents) or transaction level information. Requests from SIA member firms for such details have on occasion been denied by the NASD, or have resulted in

the furnishing of a single day's worth of data. Therefore, it has been impossible for clearing firms to calculate the amount of the total fees assessed that should be passed back to each correspondent. The Committees recognize that it is simpler for the NASD to bill clearing firms, however, by not providing transaction level detail the NASD has created a situation in which clearing firms do not know how their payments should be allocated to correspondents.

In addition, should NTM 02-09 be implemented, the current method of billing clearing firms on an aggregate basis for the transactions enumerated in Section 8 of Schedule A to the NASD By-Laws would place new operational burdens on clearing firms, as pointed out below (*see C.2., infra.*). The Committees therefore urge the NASD to develop billing solutions that address the realities of industry experience.

The Committees request that the NASD explore the feasibility of allowing clearing firms the option of having bills sent directly to executing firms or self-reporting aggregate Section 8 Fees on behalf of their correspondents. At the very minimum, the Committees urge the NASD to provide the necessary detail on the Section 8 Fee invoices. The Committees note that the NASD has mechanisms in place to track executions and could easily collect regulatory fees directly from executing firms based on those information streams.

2. It is unclear how firms are charged on internalized trades. As noted above, Section 8 of Schedule A to the NASD By-Laws appears to indicate that firms are not charged for internalized trades. NASD Rule 4632(b) generally requires an internalized trade to be reported through ACT, however, and firms apparently have been paying Section 8 Fees on internalized trades. There is some confusion, therefore, about whether the proposed language extends the current scope of fees on internalized trades or merely codifies existing practice. Member firms request that the NASD clarify this issue prior to implementing any increase in the scope of Section 8 Fees.

3. Fee collection has been based on ACT reporting as opposed to transactions.

The NASD regulatory fee has apparently been pegged to transactions subject to ACT reporting, the scope of which has changed many times over the years. It appears that the NASD has not monitored how changes in ACT reporting impact fee collection. Consequently, clearing firms may be assessed multiple fees on single transactions. For example, some SIA member firms report that they send two notifications over ACT per transaction – one to report the transaction and one to report the comparison of the transaction – and that regulatory fees are being assessed on both reports rather than on the single transaction. Consequently, clearing firms are absorbing the difference between the NASD fee calculations – as based on activity reported through ACT – and the fees calculated by clearing firms and their correspondents, which are based on transactions. The Committees are not prepared to support the changes proposed in NTM 02-09 until the NASD clarifies the existing methods for assessing fees and provides more information on how fee assessment would change as a result of adoption of the proposal in NTM 02-09.

4. Current minimum and maximum fee thresholds are no longer justified. The NASD currently imposes – and NTM 02-09 would continue to impose – a minimum fee threshold of \$0.025 per side and a maximum fee threshold of \$0.46875 per side (the fee rate is \$0.0625 per 1,000 shares). Effectively, the minimum threshold occurs at 400 shares and the maximum threshold occurs at 7,500 shares. A trade of 150 shares, for example, is therefore assessed \$0.025 in regulatory fees as opposed to \$0.009375 – the fee that would be assessed based on a flat rate of \$0.0625 per 1,000 shares. Due to decimalization, the influx of retail investors to the market in recent years, and other market developments, the average trade size has been steadily declining. While the minimum and maximum fee thresholds may have made sense when implemented in 1992, in the current market the imposition of the minimum fee threshold penalizes execution venues servicing primarily retail investors. The Committees believe that the NASD should revisit the minimum and maximum fee thresholds in the assessment of Section 8 Fees.

### **C. Concerns with the Impact of the Changes Proposed in NTM 02-09 on Member Firms**

1. The imposition of Section 8 Fees on markets not regulated by NASDR could result in members paying regulatory fees twice. The Committees believe that it would be inappropriate for the NASD to collect market regulatory fees on trades that occur in markets not regulated by NASDR. Without further clarification on this issue as to the justification and authority for charging such fees, the Committees view the extension of regulatory fees to transactions in markets the NASDR is not regulating as unjustified and possibly unfair. In addition, the Committees note that a member firm may be charged regulatory fees by both the NASD and by the market on which the transaction is executed (such as if a market that has contracted with the NASD for the provision of regulatory services were to charge its members a regulatory fee for transactions in Nasdaq securities on its market to help cover the fees it is paying to the NASD to provide that regulatory service, and the NASD also were to charge its members the Section 8 regulatory fee for the same transactions). Member firms would appreciate the opportunity to discuss this issue with the NASD.

2. Increasing scope of fees to include trades in Nasdaq stocks not reportable through ACT increases burdens to clearing firms. If the proposed changes are adopted, trades executed on and/or reported to, for example, UTP exchanges (exchanges with Unlisted Trading Privileges [UTP] for Nasdaq securities) will be assessed the NASD fees. From an operational standpoint, increasing the scope to include trades not reportable through ACT would mean that the clearing firms would be responsible for identifying, tallying, and “self-reporting” these trades to the NASD. The NASD suggested that firms could use vendors for “self-reporting” transactions not reported through ACT, but it is assumed that, at least initially, clearing firms will be responsible for “self-reporting” those trades to the NASD.

The NASD has requested comment on ways to minimize the burdens on firms that must “self-report” such transactions. The Committees submit that, while it may be





expedient for the NASD to bill clearing firms, it is unfair to place the burden of trade tracking and reporting on clearing firms. The Committees believe that the NASD should provide a mechanism for identifying and tracking trades executed outside Nasdaq systems.

### III. CONCLUSION

Based on the foregoing, the Committees respectfully request that the NASD not file the proposal announced in NTM 02-09 with the SEC for approval until it has provided the Committees with responses to the questions enumerated in this letter; revisited its overall fee assessment and collection methods – including those issues directly related to the current assessment and collection of Section 8 Fees as noted above; and taken steps to address the concerns of member firms regarding the changes proposed in NTM 02-09.

The Committees thank you for the opportunity to comment on the NASD NTM 02-09. If you have any questions or would like to discuss our comments further, please contact Mariya Rosberg of the SIA or the undersigned.

Sincerely,

Christopher R. Franke  
J.P. Morgan Chase  
Chairman, SIA Self-Regulation and Supervisory Practices Committees

George Jennison  
First Union Securities, Inc.  
Chairman, SIA Trading Committee

C Michael Viviano  
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