

approves the proposed rule change as modified by Amendment Nos. 1 and 2. Simultaneously, the Commission provides notice of filing of Amendment Nos. 3 and 4, and grants accelerated approval of Amendment Nos. 3 and 4.

## II. Summary of Comments

The Commission received a total of 23 comment letters on the NASD's proposal to eliminate the Regulatory Fee and institute the TAF,<sup>11</sup> all of which objected to the proposal, either for substantive or procedural reasons.<sup>12</sup> The following summary of comments provides an overview of the commenters' concerns.

- *The NASD Should Not Charge Its Members for Services Related to Transactions on Other Markets, Where the NASD Does Not Provide the Relevant Service*

A number of commenters stated it is improper for the NASD to collect a fee from its members relating to transactions on other markets, because in that case, other markets, not the NASD, provide the relevant services.<sup>13</sup> For example, one commenter objected to the NASD's proposal to apply the TAF to transactions for options market makers who are non-NASD members who effect a transaction on an away exchange, emphasizing that the NASD and the options exchanges share options sales practice responsibilities, and that the NASD's responsibilities "are likely to decrease, not increase in the near future."<sup>14</sup> Expanding on that theme,

options transactions for members for which the NASD is not the designated options examining authority. The NASD proposes to make this amendment effective on January 1, 2004.

<sup>11</sup> See footnotes 6, 7 and 9, *supra*.

<sup>12</sup> Some commenters expressed their disapproval that the NASD filed the initial TAF proposal for immediate effectiveness. See, e.g., Raymond James Letter. The Commission notes, however, that the point is moot, since the NASD subsequently filed SR-NASD-2002-147 and SR-NASD-2002-148, thereby allowing for full notice and comment on the proposal. Additionally, some commenters objected to the TAF being effective upon filing with the Commission because they believe the lack of notice and comment was unreasonable, and that it imposed hardship on member firms that were required to make extensive programming changes with insufficient notice. SIA Letter #1; Raymond James Letter at 1-2; SIA Letter #2 at 2, 5, 7.

<sup>13</sup> Phlx Letter at 1; CSE Letter #1 at 4-5 ("To go outside its own jurisdiction to recoup regulatory expenses without justification inappropriately places the burden for the operation and regulation of the [NASD] on other exchanges."); TD Securities Letter (TD Securities Letter concurs completely with CSE Letter #1); SIA Letter #1 at 3; CBOE Letter #2 at 2; Susquehanna Letter at 1-3; CSE Letter #2 at 1-2; STA Letter at 2; NYSE Letter #1 at 2 ("\* \* \* NASD is not empowered to act as the primary regulator across markets and over activities unique to other SROs. Consequently, no basis exists for it to impose such fees.")

<sup>14</sup> CBOE Letter #2 at 2.

another commenter suggested that the NASD provide more specific information about the costs to be borne by the NASD, and the relationship of those costs to the fees the NASD intends to charge, as well as the precise regulatory services the NASD performs and the NASD's authority to impose fees "for services not unique to it."<sup>15</sup>

- *The TAF Proposal Is Anti-Competitive Because It Indirectly Subsidizes Nasdaq by Effectively Reducing the Cost of Regulatory Services the NASD Provides to Nasdaq*

Some commenters objected to the proposed rule change on the basis that, by charging NASD members for securities transactions regardless of where a trade is executed, the NASD is providing an indirect subsidization to Nasdaq by reducing the cost to Nasdaq of regulatory services that the NASD provides to Nasdaq.<sup>16</sup> They claimed that the TAF proposal is the NASD's and Nasdaq's attempt to ensure that the revenue stream generated by trading in Nasdaq securities remains available, asserting that the NASD is subjecting transactions on competing markets to the TAF in an effort to subsidize Nasdaq's regulatory burden.<sup>17</sup>

- *Applying the TAF to Listed Options Transactions That Are Cleared by NASD Members Is Inappropriate*

Several commenters said that applying the TAF to listed options transactions that are cleared by NASD members is inappropriate because the NASD's regulatory responsibility for the listed options market is minimal.<sup>18</sup> Making a similar point, but from the opposite perspective, a number of commenters said the TAF is inequitable because the NASD will not apply the TAF to many over-the-counter instruments, such as debt and variable annuities, where the NASD has primary regulatory responsibility.<sup>19</sup>

<sup>15</sup> NYSE Letter #1 at 2.

<sup>16</sup> Phlx Letter at 2; CSE Letter #1 at 8-9; CSE Letter #2 at 3.

<sup>17</sup> See, e.g., CSE Letter #1 at 3-4; NYSE Letter #1 at 1 ("\* \* \* NASD plans to capture new revenue sources so as to supplant and supplement fees lost when Nasdaq securities began to trade on markets other than the Nasdaq. Thus, the NASD proposes to impose regulation-related costs to fill a shortfall caused by competitively induced market share loss. This approach clearly is anti-competitive."); BSE Letter at 2 ("\* \* \* they are attempting to regain market share through anti-competitive rules \* \* \*").

<sup>18</sup> CBOE Letter #1 at 1-2; CBOE Letter #2 at 2; TD ProEx Letter at 1; Susquehanna Letter at 2; STA Letter at 2; BSE Letter at 4.

<sup>19</sup> CBOE Letter #1 at 2; OCC Joint Letter #2 at 1-2; CBOE Letter #2 at 2; TD ProEx Letter at 1; STA Letter at 3; OCC Joint Letter #3 at 3-4.

- *The TAF Proposal Sets a Dangerous Precedent; a Single Transaction Could Incur Multiple Charges, Regardless of Regulatory Responsibilities or Nexus of Business Interest*

Some commenters expressed concern about the precedent the TAF proposal would set, where other self-regulatory organizations ("SROs") might impose fees on transactions executed on markets for which the SRO performs no regulatory tasks, or for which the SRO has no business interest.<sup>20</sup> However, one commenter acknowledged, "assessing a fee on trading activity occurring in other markets may be justified given the NASD's responsibility for member regulation \* \* \*" (Emphasis in original).<sup>21</sup> The commenter suggested that this concept is unprecedented, and that the impact should be examined carefully, given the concern that other self-regulatory organizations may impose similar fees, resulting in firms possibly paying considerably more than what is fair for regulation.<sup>22</sup>

- *The Interpretations in Notices to Members 02-75 and 02-63 Should Be Included in the Proposed Rule Language*

Notice to Members 02-75 states the TAF is not imposed on transactions for non-member broker-dealers who clear through an NASD member, unless the NASD clearing member firm also acts as executing broker in the transaction. Also, Notice to Members 02-63 states that transactions effected on a national securities exchange by a dually registered specialist or floor based market maker will not be subject to the TAF. Several commenters suggested that this language be included in the proposed rule language, to ensure that the language is not removed from the rule without the filing of a proposed rule change.<sup>23</sup>

<sup>20</sup> See, e.g., CBOE Letter #1 at 2; OCC Joint Letter #2 at 2 ("NASD should not be permitted to generate revenue and raise the costs of trading on the options exchanges without a showing that the amount of the TAF is limited to the recovery of its costs in connection with regulating listed options."); CBOE Letter #2 at 3; TD ProEx Letter at 2-3; STA Letter at 2; OCC Joint Letter #3 at 4; BSE Letter at 2, 4.

<sup>21</sup> SIA Letter #2 at 6.

<sup>22</sup> *Id.* ("Given this significant expansion of the scope of the fee, and the possible precedential effect it may have in the industry, we believe that the NASD should be required to provide in more detail a fair and reasonable basis for expanding the scope of the TAF to cover transactions executed in any market.")

<sup>23</sup> CBOE Letter #2 at 2 and Susquehanna Letter at 2 (regarding Notice to Members 02-75); TD ProEx Letter at 3 (regarding Notice to Members 02-63); OCC Joint Letter #3 at 6 (regarding both Notices to Members).