

• *The NASD Could Raise the Fee at Any Time*

Some commenters expressed concern that the NASD could raise the fee at any time, within its own discretion without notice and comment and Commission approval.<sup>24</sup>

• *The Proposed Rule Language is Vague and Discretionary*

One commenter stated that the proposed rule language was ambiguous, and that such vagueness would allow the NASD to “arbitrarily apply the fees to certain members while exempting others.”<sup>25</sup> The same commenter said that the proposed rule language that allows the NASD to exempt other securities and transactions as it deems appropriate would provide the NASD with discretion to create exemptions without having to present the exemptions to the Commission for approval.<sup>26</sup>

### III. The NASD's Response to Comments

The NASD responded to the comments,<sup>27</sup> discussing its rationale for the structure of its TAF proposal, and modifying the proposal to accommodate some of the commenters' concerns. The NASD's responses to the more significant issues are addressed below.

The NASD clarified that the TAF is to be used only to fund its member regulatory activities in a variety of areas such as “sales practices, routine examinations, financial and operational reviews, new member applications, enforcement \* \* \*” wherever such member activity occurs.<sup>28</sup> Although the NASD will regulate activities of its members in all securities, including Nasdaq securities, the NASD states that revenues from the TAF will not fund regulatory activities of the Nasdaq stock market, and also states that Nasdaq will not receive any subsidy based on the TAF.<sup>29</sup>

Regarding suggestions that the TAF proposal is unfair or inequitable, the NASD stated that it chose to model the TAF after the SEC's Section 31 fee to simplify its framework for recouping its regulatory costs, and, in part, to minimize the programming impact on firms.<sup>30</sup> Debt, mutual funds, and

variable annuities were excluded from the TAF, in keeping with this model, and the NASD set its Personnel Assessment and Gross Income Assessment rates at a level designed to ensure that regulatory expense levels for such products were funded fairly and adequately.<sup>31</sup> The NASD asserted that listed options are properly assessed under the TAF, since the NASD maintains regulatory responsibility for its members for options, and the “NASD continues to assume the largest share of options self-regulatory allocation through the Options Self-Regulatory Council.”<sup>32</sup> Furthermore, the NASD stated that its current costs for options regulation exceed the revenue the NASD anticipates receiving from this portion of the TAF.<sup>33</sup>

In response to the commenters' concern that the TAF proposal does not contain the exemptions to the TAF provided in *Notices to Members 02-63* and *02-75*, the NASD amended the proposed rule change to accommodate the commenters' request.<sup>34</sup>

With regard to comments that suggest that the NASD has not established a clear nexus between the TAF and the corresponding NASD regulatory responsibilities, the NASD maintained that its mandate is broad, and that its regulatory obligations “exist separate and apart from any market-specific rules and obligations.”<sup>35</sup> Additionally, the NASD filed Amendment No. 4, which creates an exemption from the TAF for listed options transactions for members for which the NASD is not the designated options examining authority.

### IV. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change, the comment letters, and the NASD's response to the comments, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations

thereunder applicable to a national securities association<sup>36</sup> and, in particular, the requirements of section 15A(b)(5) of the Act.<sup>37</sup> Section 15A(b)(5) requires, among other things, that the rules of a national securities association provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which the association operates or controls. The Commission finds that the elimination of the Regulatory Fee, and the implementation of the TAF, as described in the instant proposed rule change, is consistent with section 15A(b)(5) of the Act, in that the proposal is reasonably designed to recover NASD costs related to regulation and oversight of its members.

The Commission recognizes the difficulties inherent in restructuring the NASD's regulatory fees, and believes that the NASD has done so in a manner that is fair and reasonable. The Commission believes that the NASD's proposed TAF, in conjunction with the Gross Income Assessment, is reasonably tailored to apportion fees based on the regulatory services the NASD provides.

With respect to the commenters' assertion that the NASD should not charge its members with respect to transactions on other markets, a conclusive factor in the Commission's approval of the rule is the NASD's broad responsibilities with respect to its members' activities, irrespective of where securities transactions take place. As a national securities association, the NASD has the responsibility to oversee its members' finances and conduct toward their customers, except in limited circumstances where this responsibility is allocated to another SRO. The NASD's responsibility exists even if the conduct involves a transaction executed on a market not directly regulated by the NASD. With respect to its members doing business with the public, the NASD incurs costs to regulate its members through financial responsibility reviews, examinations, and other compliance monitoring.

The NASD's proposal uses volume of transactions as a means of allocating regulatory costs to its members, in addition to gross income and personnel fees. Assessing fees in relation to transactions correlates to heightened NASD responsibilities regarding firms that engage in the trading. In most cases,

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 5.

<sup>33</sup> *Id.*

<sup>34</sup> In response to some commenters' assertion that the NASD should codify the exemption discussed in *Notice to Members 02-75* for non-member broker-dealers that clear through an NASD member broker-dealer, unless the NASD member executes the transaction, the NASD stated that the NASD does not assess a fee on a non-NASD member for its role in effecting a transaction, regardless of where the transaction is cleared; however, if an NASD member clearing firm acts as executing broker for a non-NASD member broker-dealer correspondent, the NASD will assess a fee to the NASD clearing member. The NASD does not believe this qualifies as an exemption to the TAF, and therefore, does not think it should be included in the rule.

<sup>35</sup> *Id.* at 5-6.

<sup>36</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>37</sup> 15 U.S.C. 78o-3(b)(5).

<sup>24</sup> CBOE Letter #2 at 3 (“Even though the current level of the TAF options fee is relatively small, the NASD could raise the fee at any time. Once the NASD establishes the precedent that it can tax options trades, there will be little check on its ability to raise the fee substantially.”); Susquehanna Letter at 3.

<sup>25</sup> CSE Letter #2 at 3.

<sup>26</sup> *Id.*

<sup>27</sup> See footnote 8, *supra*.

<sup>28</sup> NASD Response Letter #1 at 3-4.

<sup>29</sup> *Id.* at 4.

<sup>30</sup> *Id.*