

securities exchange provided that the floor based broker qualifies for exemption from NASD membership under Exchange Act Rule 15b9-1;

[(viii)](H) Transactions in conventional options;

[(ix)](I) Transactions in options and futures involving narrow and broad based indexes;

[(x)](J) Transactions in security futures held in futures accounts; and

[(xi)](K) Transactions in exchange listed options effected by a member when NASD is not the designated options examining authority for that member. NASD may exempt other securities and transactions as it deems appropriate.

(3) Fee Rates *

[(i)](A) Each member shall pay to NASD a fee per share for each sale of a covered equity security.

[(ii)](B) Each member shall pay to NASD a fee per contract for each sale of an option.

[(iii)](C) Each member shall pay to NASD a fee for each round turn transaction (treated as including one purchase and one sale of a contract of sale for future delivery) of a security future.

* Trading Activity Fee rates are as follows: Each member shall pay to NASD [\$0.00005] \$0.0001 per share for each sale of a covered equity security, with a maximum charge of [\$5] \$10 per trade; \$0.002 per contract for each sale of an option; and \$0.04 per contract for each round turn transaction of a security future. In addition, if the execution price for a covered security is less than the Trading Activity Fee rate ([\$0.00005] \$0.0001 for covered equity securities, \$0.002 for covered option contracts, or \$0.04 for a security future) on a per share, per contract, or round turn transaction basis then no fee will be assessed.

(4) No Change.

(c) through (d) No Change.

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

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

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

1. Purpose

On May 30, 2003, the Commission approved the last component of a series of changes to NASD's member regulatory fee structure. Under the new fee structure, there are now three types of fees and assessments used to fund NASD's member regulatory activities: (1) Trading Activity Fee ("TAF");³ (2) Personnel Assessment; and (3) Gross Income Assessment.⁴ These fees, assessed upon and paid by member firms, are used by NASD to fund NASD's member regulatory activities, including the regulation of members through examinations, processing of membership applications, financial monitoring, policy making, rulemaking, and enforcement activities. The new member regulatory fee structure was designed to be revenue neutral to NASD and to better align NASD's regulatory fees with its functions, efforts, and costs.

Today, NASD is filing a proposal to adjust the TAF rate, and related maximum charge and minimum price exceptions, for equity securities only. NASD has been collecting the TAF for transactions effected after October 1, 2002 on a pilot basis, and has determined that the equity rate needs to be increased to ensure adequate funding levels for its member regulatory program. Therefore, NASD is proposing that the TAF be increased from 0.00005 per share to 0.0001 per share for covered equity securities, effective the first day of the month following Commission approval.

The proposed rate change is driven by lower than expected TAF revenues, not increased or unexpected member regulatory costs. NASD originally had proposed a rate of 0.0001 per share for equity securities (announced on Sept. 27, 2002 and published on NASD's Web site at http://www.nasd.com/trading_fee2.asp but after informal feedback from the membership about the level of volume meeting the definition of "covered equity security," decided to reduce the rate to 0.00005.⁵ Six months' experience with the TAF

has demonstrated that the initially proposed rate is more accurate to ensure revenue neutrality and adequate funding.

Although the current proposed rate change is driven by the need for NASD to remain revenue neutral in its transition from the old member regulatory funding structure, consistent with its stated policy, NASD periodically will analyze rates, volumes, and regulatory responsibilities to ensure adequate funding levels for its member regulatory programs.⁶ NASD also will perform an analysis for the annual Personnel Assessment and Gross Income Assessment, to ensure adequate contributions from each component fee, as well as adequate levels of funding overall. In addition, NASD previously stated its intent to reduce the percentage that the TAF contributes to the overall funding structure in 2004 and again in 2005 (increasing the percentage funded by the PA and holding the GIA percentage static). NASD remains committed to that program, and should regulatory costs and market volumes remain constant, fee levels for 2004 could be expected to drop by approximately 20%. Of course, NASD will analyze all relevant factors prior to making that filing.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act, which requires, among other things, that NASD's rules provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system that NASD operates or controls. The TAF is objectively allocated to NASD members. Moreover, the NASD believes the level of the fee is reasonable because it relates directly to the recovery of the costs of regulating members.

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

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

³ Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34012 (June 6, 2003) (approval order).

⁴ Securities Exchange Act Release No. 47106 (December 30, 2002), 68 FR 819 (January 7, 2003) (approval order).

⁵ See Securities Exchange Act Release Nos. 46818 (Nov. 12, 2002), 67 FR 69782 (Nov. 19, 2002) (approving SR-NASD-2002-147) and 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (approving SR-NASD-2002-148).

⁶ Specifically, NASD stated in the text of the TAF rule language that it will "periodically review these revenues in conjunction with these costs to determine the applicable rate." NASD By-Laws, Schedule A, Section 1(a).