

(h)–(s) 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, Nasdaq 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. Nasdaq 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 the Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

ACT is an automated trade reporting and reconciliation service that speeds the post-execution steps of price and volume reporting, comparison, and clearing of trades completed in Nasdaq, OTC Bulletin Board, and other over-the-counter securities. ACT handles transactions executed through Nasdaq's automated trading systems, as well as transactions negotiated over the telephone and internalized transactions. It also manages post-execution procedures for transactions in exchange-listed securities that are traded in the Nasdaq InterMarket.

Nasdaq recently filed proposed rule changes to reduce ACT fees for (i) reports for transactions in Nasdaq National Market and SmallCap Market securities submitted to ACT by a market participant directly or through Nasdaq's Primex system,<sup>9</sup> and (ii) reports of transactions that are executed through SuperMontage (or any other transaction execution system that uses SuperMontage's functionality to report transactions).<sup>10</sup> According to Nasdaq, however, based on input received from members, Nasdaq has concluded that these price reductions may not be sufficient to allow Nasdaq to compete effectively for the orders of certain members.

Nasdaq states that it faces competition from market centers that are willing to offer market participants free trade

reporting services,<sup>11</sup> and that effectively share market data revenue associated with transactions in Nasdaq-listed securities by "mutualizing" revenues with certain members,<sup>12</sup> notwithstanding the Commission's Order of Summary Abrogation (the "Order") regarding market data revenue sharing programs.<sup>13</sup> Nasdaq asserts that by mutualizing revenues, a competitor with a comparatively small number of market participants can seek to attract the trade reporting activity of large firms, because a substantial percentage of the revenues associated with a new participant's trade reports will end up being shared with that participant. Nasdaq believes that, by contrast, a similar program instituted by Nasdaq would be competitively ineffective and administratively impractical, because Nasdaq's revenues must support a broader range of market and regulatory programs and because revenues would have to be shared across a broader base of market participants. Nasdaq believes that the resulting competitive environment is fundamentally unfair, because Nasdaq can neither share information revenues directly nor engage in mutualization of revenues. Nasdaq states that it can cut its fees to zero, but certain of its competitors can pay for trade reports. Moreover, Nasdaq believes that market centers that seek to use mutualization as a means of enticing trade reports also benefit from regulatory programs and systems funded predominantly by Nasdaq, and therefore profit from an inequitable apportionment of regulatory costs.<sup>14</sup>

Accordingly, Nasdaq has sought to compete through wide-ranging price reductions across multiple services.<sup>15</sup>

<sup>11</sup> See, e.g., Securities Exchange Act Release No. 47331 (February 10, 2003), 68 FR 7635 (February 14, 2003) (SR-NASD-2003-09) (eliminating trade reporting fees associated with the NASD's Alternative Display Facility).

<sup>12</sup> See Securities Exchange Act Release No. 46688 (October 18, 2002), 67 FR 65816 (October 28, 2002) (SR-CSE-2002-14) (describing the Cincinnati Stock Exchange's general revenue sharing program).

<sup>13</sup> See Securities Exchange Act Release No. 46159 (July 2, 2002), 67 FR 45775 (July 10, 2002).

<sup>14</sup> See Securities Exchange Act Release No. 47849 (May 14, 2003), 68 FR 27722 (May 20, 2003).

<sup>15</sup> See SR-NASD-2003-86 (May 22, 2003) and Securities Exchange Act Release No. 47621 (April 2, 2003), 68 FR 17418 (April 9, 2003) (SR-NASD-2003-56) (reporting of SuperMontage trades); Securities Exchange Act Release No. 47661 (April 10, 2003), 68 FR 19045 (April 17, 2003) (SR-NASD-2003-51) (other trade reports for Nasdaq National Market and SmallCap Market securities); Securities Exchange Act Release No. 47648 (April 8, 2003), 68 FR 17972 (April 14, 2003) (SR-NASD-2003-53) and Securities Exchange Act Release No. 47612 (April 1, 2003), 68 FR 17137 (April 8, 2003) (SR-NASD-2003-54) (Nasdaq Testing Facility); Securities Exchange Act Release No. 47637 (April 7, 2003), 68 FR 17849 (April 11, 2003) (SR-NASD-2003-47) and Securities Exchange Act Release No. 47679 (April

Nasdaq states that its goal in designing the ACT price reductions, however, was to ensure that a member's ACT activity continued to have actual costs associated with it. Accordingly, for non-SuperMontage reports, Nasdaq adopted a graduated fee schedule, in which the price paid for "marginal" trade reports decreased from \$0.029 to zero as trade reporting volume increased, but in which each participant would still be assessed a charge for a substantial number of its trade reports each month. Nasdaq asserts that it has also made SuperMontage reports free in some cases, but only if a member's volume of SuperMontage transaction reports is sufficiently high to allow Nasdaq to conclude that the loss of ACT revenue for SuperMontage reports would be at least partially offset by transaction execution revenue, market data revenue, and fees for value-added ACT services, such as trade comparison and browse/query.

As noted above, however, Nasdaq has now concluded that these price reductions may not be adequate to allow Nasdaq to compete effectively. Accordingly, Nasdaq is proposing to completely eliminate the ACT charge for non-SuperMontage reports of transactions in Nasdaq National Market and SmallCap Market securities that are not subject to comparison through ACT. Thus, the current graduated fee schedule—which applies to all reports in Nasdaq National Market and SmallCap Market securities submitted to ACT by a market participant directly or through Nasdaq's Primex system, including reports submitted pursuant to "automated give-up" ("AGU") and Qualified Service Representative ("QSR") arrangements,<sup>16</sup> as well as internalized trades and Primex trades—would be eliminated.<sup>17</sup>

#### 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the

15, 2003), 68 FR 19593 (April 21, 2003) (SR-NASD-2003-48 (March 28, 2003) (NWII logons); Securities Exchange Act Release No. 47608 (April 1, 2003), 68 FR 17134 (April 8, 2003) (SR-NASD-2003-43) and Securities Exchange Act Release No. 47607 (April 1, 2003), 68 FR 17136 (April 8, 2003) (SR-NASD-2003-46) (computer-to-computer interface pricing); and Securities Exchange Act Release No. 47300 (January 31, 2003), 68 FR 6234 (February 6, 2003) (SR-NASD-2003-10) (quotation update fees).

<sup>16</sup> AGU and QSR arrangements allow a participant to report trades executed with other brokers with whom they have entered into a contractual arrangement.

<sup>17</sup> In this filing, Nasdaq is also proposing to move the text of the footnotes to NASD Rule 7010(g) into the text of the rule, to improve the rule's presentation in the NASD Manual, and is also making minor modifications to the existing rule text to enhance its clarity.

<sup>9</sup> See Securities Exchange Act Release No. 47661 (April 10, 2003), 68 FR 19045 (April 17, 2003) (SR-NASD-2003-51).

<sup>10</sup> SR-NASD-2003-86 (May 22, 2003); see Securities Exchange Act Release No. 47621 (April 2, 2003), 68 FR 17418 (April 9, 2003) (SR-NASD-2003-56).