

# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Compliance  
Legal  
Operations  
Senior Management

## KEY TOPICS

NASD By-Laws  
Trading Activity Fee  
Section 8(a) Regulatory Fees

## INFORMATIONAL

### Trading Activity Fee

NASD Provides Additional Information on the Trading Activity Fee

### Executive Summary

As announced in *Notice to Members 02-41* and *Special Notice to Members 02-63*, NASD has amended Section 8(a) of Schedule A to NASD's By-Laws, eliminating the Regulatory Fee and instituting a new transaction-based Trading Activity Fee which funds NASD's member regulatory activities.<sup>1</sup>

### Questions/Further Information

Questions concerning this *Notice* should be directed to NASD Finance, at (240) 386-5397, or NASD Regulatory Policy and Oversight, Office of General Counsel, at (202) 728-8071.

### Discussion

NASD has amended Section 8(a) of Schedule A to NASD's By-Laws to eliminate the Regulatory Fee and to institute a new transaction-based Trading Activity Fee. This fee is used by NASD solely to fund NASD's member regulatory activities, including the supervision and regulation of members through examinations, processing of membership applications, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. The Trading Activity Fee does not fund Market Regulation activities which are funded solely through contracts with NASDAQ and other exchanges.

These changes were originally submitted to the Securities and Exchange Commission (SEC) for immediate effectiveness. On Friday, October 18, 2002, NASD filed with the SEC two subsequent but related rule filings. The first is a proposed rule change<sup>2</sup> filed with the SEC for immediate effectiveness that established a sunset provision that terminates on December 31, 2002 the proposed

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changes made to Schedule A to NASD's By-Laws. The second rule filing<sup>3</sup> contains substantially the same rule language as originally proposed, but was submitted pursuant to Section 19(b)(1) of the Act<sup>4</sup> to allow for an additional notice and comment period. NASD filed this in response to comments made by NASD's members that the Trading Activity Fee should not be filed as immediately effective, but instead should be given a full notice and comment period. In addition, this subsequent comment period allows NASD to further examine the impact of the Trading Activity Fee rates effective upon implementation and ensure they are consistent with NASD's overall intention that amendments to its pricing structure be revenue neutral.<sup>5</sup>

### Trading Activity Fee Initial Rate Structure

NASD previously announced the initial rate structure for the Trading Activity Fee effective October 1, 2002. Based on further analysis of trading volumes and feedback from member firms, the rate structure has been further adjusted, retroactively effective to October 1, 2002. Adjustments to the rate structure are: 1) the initial rate of \$0.0001 for covered equity securities has been reduced to \$0.00005, 2) the maximum on covered equity securities has been reduced to \$5.00, 3) the initial rate of \$0.08 for security futures has been reduced to \$0.04, and 4) the minimum exclusion has been extended to cover options and futures. The adjusted rate structure is as follows:

- ◆ Each member shall pay to NASD \$0.00005 per share for each sale of a covered equity security, with a maximum charge of \$5 per trade.

- ◆ Each member shall pay to NASD \$0.002 per contract for each sale of an option.
- ◆ Each member shall pay to NASD \$0.04 for each round turn transaction of a security future.

Additionally, if the execution price for a covered security is less than the Trading Activity Fee rate (\$0.00005 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.

NASD is filing the above initial rate structure with the SEC for immediate effectiveness. Additionally, NASD intends to file any further modifications to the Trading Activity Fee rate structure with the SEC.

### Submission/Payment Information

Traditionally, the Section 8(a) Regulatory Fee had been assessed on clearing firms on behalf of members. Although reporting obligations are ultimately the responsibility of the member, the Trading Activity Fee will continue to be assessed directly to the clearing firms responsible for clearing the transaction on behalf of the member firm.

In consideration of programming constraints and due to the further refinement of the initial rate structure, NASD has extended the submission and payment date for the October 1, 2002 through December 31, 2002 time period. Firms may self-report and remit payment to NASD for this time period no later than January 15, 2003.

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The prescribed form of the monthly report is available on the NASD Web Site at [www.nasd.com](http://www.nasd.com). Firms will be required to self-report to NASD the aggregate shares for stocks, aggregate number of contracts for options, and/or aggregate number of contracts traded on a round turn basis for security futures products at the clearing firm level only. For the October 1, 2002 through December 31, 2002 time period, a separate form for each month must be submitted.

The monthly report and payment may be submitted to NASD by either US mail or overnight Express mail as follows:

**For US mail delivery:**

NASD  
P.O. Box 7777-W8555  
Philadelphia, PA 19175-8555

Note: This P.O. Box will not accept courier or overnight deliveries.

**For courier & overnight deliveries:**

NASD  
W8555 c/o Mellon Bank, Rm 3490  
701 Market Street  
Philadelphia, PA 19106  
Phone number: 215-553-0697

(if required for the recipient)

If other payment methods are required, please call NASD Finance, at 240-386-5394.

## Questions and Answers

**Question 1:** The answer to Question 4 in the Question and Answer Section of *Special Notice to Members 02-63*, stated that although the general model is to assess the Trading Activity Fee on the sell side of

member transactions, the Trading Activity Fee would be assessed on the buy side of member transactions where the counter party is not a broker/dealer. The answer further stated that NASD members will be charged a Trading Activity Fee when they are on the buy-side of a transaction with a non-broker/dealer (e.g., internalized trade). Since the rule states that each member shall pay a fee for each sale of a covered security, does this mean that for a transaction in which the sell-side is a customer and the buy-side is a member, two fees will be charged?

No. More simply stated, a fee will be assessed on all sell side transactions. This includes both transactions where the sale is for the account of a customer and transactions where the sale is for the member itself.

**Question 2:** If a member effects a sale for a customer on an agency basis, will the member be assessed a fee?

Yes. If a member acts as agent for a non-broker/dealer customer in the sale of a covered security, the member will be assessed a fee for that transaction.

**Question 3:** If a member effects a sale for another NASD member on an agency basis, will the member acting as agent be assessed a fee?

No. If a member acts as agent on behalf of another NASD member in the sale of a covered security, the fee will be assessed to the member who is the ultimate seller of the security, not the member acting as agent.

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**Question 4:** How is the Trading Activity Fee calculated when a member uses an average price model to effect transactions on an agency basis for its customers?

A member may choose to calculate the Trading Activity Fee on either the individual street side executions or on the account level average price confirmation if that member can link the street side executions to the account level average price confirmation(s). However, the methodology chosen by the member to calculate the fee assessment must be consistently applied to all average price transactions and must be documented by the member.

**Example 1.** A customer places an order to sell one million shares of a covered security and the member executes ten 100,000 share trades that are then allocated to the customer on an average price basis. If the member can link the ten street side trades to the one million share average price confirmation to the customer, the member may calculate the fee based on either the ten street side trades (ten sales at \$5) or on the account level average price confirmation to the customer (one sale at \$5).

**Example 2.** An investment advisor places an order to sell one million shares of a covered security. The member then executes ten 100,000 share trades to fill the investment advisor's order. The investment advisor subsequently allocates the one million shares to four separate customers. If the member can link the ten street side trades to the four account level average price confirmations, the member may calculate the fee based

on either the ten street side trades (ten sales at \$5) or on the account level average price confirmations (four sales at \$5). The member may not calculate the fee based on the million share order from the investment advisor (one sale at \$5) because it is comprised of multiple customer accounts.

**Question 5:** Schedule A to NASD's By-Laws, Section 2(b)(3)(iii) states "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". Does this mean that the fee will be assessed on a per contract basis?

Yes. Example: A member opens a position (long or short) of 100 contracts. No fee is assessed when the position is opened because the fee assessment is based on a round turn transaction. The member later closes half of its original 100 contract position. When the member closes out the 50 contracts, it will be assessed a fee of \$0.04 x 50 contracts, totaling \$2.

**Question 6:** Will the Trading Activity Fee be assessed on transactions for non-member broker-dealers who clear through an NASD member broker-dealer.

No. The Trading Activity Fee only applies to NASD member firms. However, if the NASD member clearing firm also acts as the executing broker in a transaction, then the NASD clearing member will be assessed a fee for that transaction.

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**Question 7:** The rate structure includes a maximum charge per trade of \$5 for covered securities. Does this apply to options and security futures?

No. The maximum charge was established for equity securities, particularly for the very low priced over-the-counter securities that often trade in large share quantities.

## Endnotes

- 1 These changes were submitted to the SEC (for immediate effectiveness) on July 23, 2002 and amended on August 21, 2002. See Securities Exchange Act Release No. 46416 (August 23, 2002), 67 FR 55901 (August 30, 2002) (SR-NASD-2002-98).
  - 2 See SR-NASD-2002-147.
  - 3 See SR-NASD-2002-148.
  - 4 15 U.S.C. 78s(b)(1).
  - 5 This proposed rule filing is to be read in conjunction with SR-NASD-2002-99. The two separate yet related rule filings are the result of a review of the overall NASD pricing structure and will be used to fund NASD's member regulatory activities.
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