



October 31, 2005

Ms. Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1506

Re: File No. **NASD Notice to Members 05-61**

Dear Ms. Sweeney:

Automated Trading Desk, LLC ("ATD")¹ appreciates this opportunity to comment on the National Association of Securities Dealers ("NASD") Notice to Members 05-61. Of primary concern in this Notice to Members is footnote number 5 discussing the proper allocation of the Trading Activity Fee ("TAF") when utilizing riskless principal trading.

ATD is concerned with the apparent inconsistency of the application of TAFs in the context of riskless principal transactions effected between two broker/dealers. First, NASD Notice to Members 02-63, question 14, establishes that only one TAF will be assessed in a riskless principal transaction.

Question 14. If a firm executes a trade on a riskless principal basis, will a fee be assessed on both the initial leg of the transaction and the offsetting transaction to the customer?

No. Riskless principal transactions reported correctly will be viewed as one transaction for purposes of assessing the Trading Activity Fee.²

The NASD then, in Notice to Members 02-75, clarified that assessing a TAF against the agent firm in broker-to-broker transaction is not appropriate.

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 [TAF] fee?

No. If a member acts as agent on behalf of another NASD member in the sale of a covered security, the [TAF] fee will be assessed to the member who is the ultimate seller of the security, not the member acting as agent.³

However, in apparent conflict with this interpretation, the NASD states in Notice to Members 05-61, footnote 5, that a firm handling a sale for another broker on a riskless principal basis will be assessed the TAF, not the originating firm.

¹ ATD is a technology firm that develops software and systems for the use of its brokerage subsidiaries to trade NASDAQ and listed equities on an automated basis. ATD is the sole owner of Automated Trading Desk Financial Services, LLC ("AUTO"), a market-making firm, and Automated Trading Desk Brokerage Services, LLC, an order entry firm. AUTO provides execution services for a broad spectrum of retail order-sending firms. Year-to-date, ATD has accounted for approximately 5% of all NASDAQ daily trades and 3% of all NYSE daily trades.

² NASD Notice to Members 02-63.

³ NASD Notice to Members 02-75.

[Footnote 5]. See Notice to Members 02-63, Question 14, which states that riskless principal transactions reported correctly will be viewed as one transaction for the purposes of assessing the TAF. *Because the TAF is applied in a manner consistent with Section 31 of the Exchange Act and Rule 31 thereunder, this results in the first leg of a riskless principal transaction being assessed while the second leg of the transaction with the customer being exempt from the fee.*⁴

This interpretation neither accurately reflects prior NASD guidance on the assessment of TAFs, nor accurately reflects the way in which firms currently report TAFs in riskless principal transactions.

Order sending firms generally mark sell transactions as TAF liable upon receipt or routing of the order to sell.⁵ Therefore, order execution firms (market makers, etc.) handling transactions on a riskless principal basis generally do not assess a TAF on sell transactions handled on a riskless principal basis. Otherwise, both the sending firm and the executing firm would be paying a TAF, a result that the NASD expressly has disavowed.⁶

With all due respect, it appears that the inconsistency of the interpretation lies, at least in part, on the NASD's determination that TAFs are *similar* to SEC Section 31 fees. The SEC imposes a Section 31 fee on the aggregate dollar amount of sales of securities transaction on an exchange or by a national securities association. The exchanges and the NASD assess the SEC Section 31 fees to their members. Thus, for all liable sell transactions, a regulatory bill is generated by the NASD or the exchanges. These, in turn, are commonly passed along to the originating seller. The NASD TAF, on the other hand, is a completely self-reported fee.

Contrast the calculation and imposition of SEC Section 31 fees with the self-reported TAFs. In the context of assessing TAFs, an evaluation of the life of an order may be the simplest comparison. For example, an order sending firm sends two sell orders for execution to a member broker-dealer. The first transaction is executed by the receiving firm as riskless principal and the second as principal. Current industry practice is that executing firms do not generally disclose order execution capacity (principal or agent) in the execution message to the order-sending firm. Moreover, there are no SEC Rule 10b-10 confirmations to disclose capacity as the transactions are broker-to-broker. When the order-sending firm uploads data to its clearing firm, there is no indication of capacity of the executing broker-dealer. However, the clearing firm must now report its correspondent's TAF-eligible trades to the NASD. As there is no way to determine if the transaction was executed by the receiving firm as principal or as riskless principal, the clearing firm will report both sell transactions as TAF liable. If the executing broker-dealer is also required to report this "first leg" of the transaction as TAF liable, it too will pay the TAF. Herein lies the problem. The NASD will have collected the TAF twice on the same transaction.⁷

To achieve a result where the TAF is paid by the broker handling the order on a riskless principal basis and not by the order sending firm would require extensive modifications to how the industry processes order information, how clearing firms process information, and how (ultimately) these fees get paid. However, this is an unnecessary burden to impose on the industry, because a perfectly acceptable solution is available. The NASD should simply allow order sending firms to document that an order is

⁴ See NASD Notice to Members 05-61, footnote 5 (emphasis added).

⁵ These firms often pass these costs along to their customers, similar to how fees assessed pursuant to SEC Section 31 are handled. Of course, there is no obligation for these firms to pass along such fees to the ultimate customer, but this is a general practice.

⁶ Telephone conversations with the NASD's Finance Division.

⁷ Because the second execution was handled as principal by the executing firm, the order sending firm will report the sell as TAF and the executing firm will not report a TAF (as the buyer of the order sending firm's sell order). However, if both the order sending firm and the executing firm self-report the TAF, both firms will pay on the same order, and the NASD will have no ability to reconcile the overage.

TAF liable upon receipt/route of a customer sell order. There is no need for the receiving (executing) firm to report anything, because the sending firm has already appropriately assessed the single TAF due on the transaction. In other words, the current practice works, and should not be changed pursuant to the NASD's latest interpretation.

The overpayment of TAFs caused by the NASD's interpretation of riskless principal trading, a double taxation so to speak, is not at all consistent with the letter or spirit of the TAF rule. In addition, it places the order-sending firm or the executing firm in the rather awkward position of having to request from the NASD a refund of overpaid TAFs (if, indeed, there is any manner in which to determine what fees have been overpaid).

ATD respectfully requests that the NASD confirm its earlier guidance that TAFs are not assessed to brokers acting as riskless principal in sell transactions for other broker/dealers. This result would be consistent with both the TAF rules as written and current industry practice.

ATD appreciates the opportunity to submit its viewpoints on these matters, and we would be happy to discuss these issues further.

Sincerely,



Shane Swanson
General Counsel and Director of Compliance
Automated Trading Desk, LLC