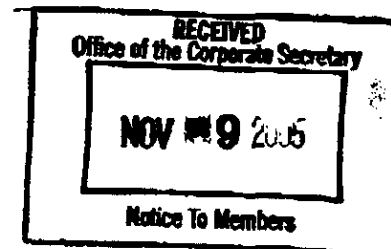


Charles SCHWAB

JEFFREY T. BROWN Senior Vice President
Office of Legislative and Regulatory Affairs
555 12th Street NW Suite 740N Washington D C 20004
tel (202) 682 4902 fax (202) 638 3823
jeff.brown@schwab.com

November 8, 2005

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



Re: Notice to Members 05-61

Dear Ms. Sweeney:

Charles Schwab & Co. appreciates the opportunity to respond to the request for comments outlined in Notice to Members 05-61 ("Notice"). Although the expressed purpose of the proposal is to realign the assessment of a transaction activity fee ("TAF") to spread the fees among a wider group of market participants, ostensibly to make the fees fairer, we do not believe that the NASD has provided sufficient information to demonstrate that the possible changes outlined by the Notice represent an efficient and fair means of allocating regulatory costs.

Based on the Notice, we understand that the rationale for reviewing the current assessment policies is that these policies discriminate against a small segment of the industry that has no interface with public customers, but we submit that this rationale, without any underlying support, does not validate shifting the regulatory burden to firms that do interface with customers. Under the present TAF, the segment of the industry assessed includes those involved in a class of transactions - those involving a market maker and another broker-dealer - in which there is no public customer, although the majority of these transactions represent the first leg of riskless principal transactions necessary to effect customer orders. With the Notice, the NASD seeks member views on a possible restructuring of the current TAF to assess any customer transaction in a covered security, regardless of whether an NASD member firm is on the buy or sell side of the transaction. As we explain below, we believe that the NASD has not provided sufficient information to justify such a restructuring, and, more specifically, we question whether the possible restructuring is equitable as required by the Exchange Act.

I. Additional Information is Necessary to Comment.

As set forth in the Notice, the purpose of the "realignment" is to spread the TAF over a wider group of NASD members, re-distributing the fee in part from firms or business lines within firms that execute large numbers of transactions to firms or their business lines within firms that deal directly with public customers. At the outset, we note there is not enough information in the Notice to enable a commenter to respond adequately on this topic. We believe

that additional information is necessary to enable members to make informed comments on the Notice; and in that regard, we offer two suggestions.

First, the NASD should provide more detailed financial analysis to support a possible realignment. Among other things, the Notice states that the NASD will "re-analyze revenues and expenses to determine the appropriate rate reduction needed in order to reduce the share of the member regulatory program funded by transaction activity." We submit that the NASD should make publicly available the analysis undertaken to justify the current TAF and then to make publicly available whatever analysis that has been undertaken to justify the possible realignment. Otherwise, we are unable to comment fully on whether the possible realignment is equitable as required by the Exchange Act.

Our concerns with respect to the lack of data are enhanced because the position announced in the Notice appears directly at odds with the position of the NASD taken only two years ago. In its reply to commenters in connection with the current fee assessment, the NASD responded to complaints that it was unfair to parcel out expenses on a transaction-by-transaction basis, or product-by-product. The NASD noted that: *"NASD believes that trading activity of members, in combination with total revenues of a broker/dealer member and the number of registered persons, serves as an effective proxy for what drives NASD's member regulatory costs."*¹ What has changed in two years? We are unclear as to the basis in support of the suggestion contained in the Notice that "restructuring of the scope of the TAF would better align that fee with NASD's costs."

Finally, the SEC recently proposed enhancements to the SRO governance structure that includes transparency and reporting rules which, if approved, will require SROs to file quarterly and annual reports about their regulatory programs, as well as other information regarding revenues, expenses and their relation to regulation of SROs.² In our judgment, exactly this type of information from the NASD should be produced and made publicly available before acting on any possible realignment of the TAF.

II. The proposed realignment appears to be arbitrary and anticompetitive.

Presumably, the NASD is suggesting that firms that deal with public customers receive more regulatory scrutiny, and account for a greater portion of regulatory costs than those which do not. As set forth above, though, without any data, it is impossible to comment adequately on this assumption. However, it is our belief that regulatory costs for policing organizations such as Schwab are already disproportionately funded by the NASD's personnel and general income assessments than those of market making firms.

In addition, our customer orders generate trading activity from which the market making firms profit. Naturally, that trading activity generates regulatory costs, costs that the NASD presumably bears in overseeing market makers. Under the possible realignment of the TAF

¹ File No. SR-NASD-2002-148 -- Proposed Rule Change to By-Laws Regarding the Regulatory Fee and the SEC Section 31 Transaction Fee; Response to Comments and Amendment No. 3 (March 18, 2003).

² Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126.

outlined in the Notice, however, our customers would not only be generating profits for the making making firms but also would be paying for the regulatory costs generated by their trading activity. We submit that this circumstance renders the possible realignment even less equitable than the current TAF.

Further, order entry firms already bear a substantial, and discriminatory, burden in the form of market data fees, which are used to support regulatory functions of NASD market makers acting through the Nasdaq Stock Market. Forcing order entry firms to collect additional fees on a per transaction basis would impose an additional burden on a class of retail investors who already carry a disproportionate share of the burden with respect to market data fees. As we have noted on numerous occasions in the past, the current collection mechanism for market data discriminates against firms offering quotes directly to retail investors; yet market data fees provide the Nasdaq with the funds to support the contract between the NASD and Nasdaq for regulatory services, services directly related to regulation of market makers. We believe that the possible realignment of the TAF outlined in the Notice would compound this regulatory funding burden by imposing increase fees upon order entry firms on top of the already disproportion of the costs for the regulation of Nasdaq.³

III. Conclusion

Without sufficient information concerning the costs associated with regulating the individual classes of market participants, or any more specific plans for reallocating costs, it is difficult to present fully informed views on the current proposal. Knowing that the NASD wishes to fairly allocate its regulatory costs among its members, we believe that further dialog with the NASD is necessary to alleviate our concern that the proposed change to the TAF exacerbates an already disproportionate regulatory cost burden imposed on order entry firms and their customers. We look forward to that dialog.

Sincerely,


Jeffery Brown
Senior Vice President
Legislative and Regulatory Affairs

³ We are concerned that exempting market makers from the TAF may equate to a subsidy to Nasdaq from the TAF, which we believe would be at odds with a NASD representation embodied in the SEC approval order for the current TAF. This order provided that "[a]lthough 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." Rel. No. 34-4796, 68 FR 34021 (June 6, 2003).