

# Special Notice to Members

SEPTEMBER 2002

## SUGGESTED ROUTING

Compliance  
Legal  
Senior Management

## KEY TOPICS

NASD By-Laws  
Regulatory Fee

## INFORMATIONAL

### Regulatory Fees

NASD Provides Additional Information on Amendments to Section 8 of Schedule A to NASD's By-Laws to Eliminate the Regulatory Fee and to Implement a New Transaction-Based Trading Activity Fee as Announced in *Notice to Members 02-41*; **Implementation Date: October 1, 2002**

### Executive Summary

As announced in *Notice to Members 02-41*, NASD has amended Section 8 of Schedule A to the NASD 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> NASD will implement these changes on October 1, 2002.

Included with this *Notice* is Attachment A, the text of the amendments to Schedule A to the NASD By-Laws.

### 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 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. As further detailed below, NASD will implement this rule change and assess the new Trading Activity Fee effective October 1, 2002.

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NASD currently assesses a Regulatory Fee upon its members through approximately 250 clearing and self-clearing firms on all transactions reported through Nasdaq's Automated Confirmation Transaction service (ACT). There is a 400 share minimum and 7,500 share maximum per transaction. The Regulatory Fee is assessed only against Nasdaq and other off-exchange transactions, although the revenues are used to support member regulatory activities across all markets. The amendment eliminates the existing Nasdaq market-based Regulatory Fee and institutes a transaction-based Trading Activity Fee applied across all markets. The Trading Activity Fee will be assessed on the sell-side of all member transactions in all covered securities regardless of where the trade is executed, with the exception that the fee will be assessed on the buy-side of member transactions in the case of transactions where the counterparty is not a broker/dealer (e.g., internalized customer trades).<sup>2</sup> Specifically, covered securities are: 1) all exchange-registered securities wherever executed (other than bonds, debentures, and other evidence of indebtedness); 2) all other equity securities traded other than on an exchange; and 3) all security futures wherever executed.

NASD anticipates that changes in the rate structure will ultimately reduce the revenue from the collection of the Trading Activity Fee by approximately 50%. This change in conjunction with the proposed amendments to the Gross Income Assessment and Personnel Assessment will be revenue neutral to NASD.<sup>3</sup> To minimize the impact on member firms, the restructuring of fees will be phased in over a three-year period. Specifically, for the Trading Activity Fee, since the revenue generated from this fee will be reduced by approximately 50%, the fee reduction will be

phased in at a rate of 33% in Year 1 (16.5% reduction), 67% in Year 2 (33.5% reduction) and 100% in Year 3 (50% reduction).

The rate to be assessed for the Trading Activity Fee is currently being developed based on industry data for NASD members' transactions in covered securities. NASD will publish the applicable rate no later than the implementation date, October 1, 2002.

Traditionally, the 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. Clearing firms will be required to self-report to NASD on a monthly basis the aggregate shares for stocks, aggregate number of contracts for options, and/or aggregate number of round turn transactions for security future products at the clearing firm level. Submission segregated by exchange is optional and will not be required by NASD. Clearing firms will be required to self-report to NASD the required data and submit payment 10 business days following the end of the month. For example, for October 2002 transactions, clearing firms will be required to self-report and remit payment by November 14, 2002. The prescribed form of the monthly report will be published prior to the filing deadline.

### Implementation Date

NASD will implement this amendment beginning on October 1, 2002. The first self-reporting and payment will be due November 14, 2002.

## Questions and Answers

**Question 1:** Are transactions effected on a national securities exchange by a dually registered specialist or floor based market maker, covered by the Trading Activity Fee?

No. Proprietary transactions by a jointly registered NASD member, in its capacity as an exchange specialist or market maker, that are subject to SEC Section 11(a) and SEC Rule 11a1-1(T)(a) thereunder, are excluded from the scope of the Trading Activity Fee. However, any other transactions permitted by SEC Section 11(a), such as bona fide arbitrage or hedge transactions involving a long or short position in an equity security, will be subject to the Trading Activity Fee.<sup>4</sup>

**Question 2:** Are transactions executed by floor based brokers who are dually registered with NASD and a national securities exchange exempt from the Trading Activity Fee?

Yes. If the floor based broker qualifies for exemption from NASD registration under SEC Rule 15b9-1, then any transactions effected by that broker will be exempt from the Trading Activity Fee.

**Question 3:** If a non-NASD member floor broker executes a trade on an NASD member's behalf on the floor of a national securities exchange, will a fee be assessed on the floorbroker?

No. Non-NASD member floor brokers acting as agent on an NASD member's behalf will not be assessed the Trading Activity Fee. However, the NASD

member, the seller of the security, will be assessed the Trading Activity Fee on the transaction.

**Question 4:** If an NASD member purchases a covered security from a non-NASD member broker/dealer, will the NASD member's transaction be assessed a fee even though the rule provides for a fee assessment only on sales of covered securities?

No. As noted above in the text of the *Notice*, although the general model is to assess the Trading Activity Fee on the sell side of the member transactions, the Trading Activity Fee will be assessed on the buy side of member transactions in transactions where the counterparty is not a broker/dealer. Because clearing firms have significant operational constraints that prevent them from efficiently identifying transactions with non-NASD member broker/dealers, no fee will be assessed on NASD member's transactions for purchases of covered securities from non-NASD member broker/dealers. In contrast, 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., an internalized trade).

**Question 5:** Schedule A to NASD's By-Laws, Section 2(b)(3), states that "each member shall pay to NASD a fee per share for each sale of a covered security." Will Electronic Communication Networks (ECN) that employ so called "facilitation" accounts to maintain the anonymity of their subscribers, be assessed a fee on transactions flowing through these facilitation accounts.

No. In transactions where an ECN is acting as a contraparty for the purpose of maintaining the anonymity of its subscribers, the Trading Activity Fee will be assessed as if the two subscribers had engaged in the transaction directly.

**Question 6:** Are debt securities excluded from the scope of the Trading Activity Fee?

Yes. Consistent with SEC Section 31 Fees, debt securities including convertible debt are not included in the scope of the Trading Activity Fee.

**Question 7:** Are conventional options traded over the counter excluded from the scope of the Trading Activity Fee?

Yes. However, while the initial sale of a conventional option contract is excluded from the Trading Activity Fee, any resulting exercise will be subject to the Trading Activity Fee if the exercise results in the physical delivery of the underlying securities. See *also* Question 10.

**Question 8:** How does NASD interpret the term “round turn” as it relates to assessing the Trading Activity Fee on security futures products?

For purposes of applying the Trading Activity Fee to security futures products, a round turn transaction is defined as a purchase and subsequent liquidating sale, or a sale followed by a subsequent covering purchase, of a contract for future delivery by a single market participant.

**Question 9:** The Trading Activity Fee includes in its definition of a covered security “all security futures wherever executed.” An NASD member firm can be both a Futures Commission Merchant (FCM) and an NASD registered broker/dealer and therefore, can hold both futures accounts, which are regulated by the National Futures Association (NFA), and securities accounts, which are regulated by NASD. Does the Trading Activity Fee apply to transactions in the futures accounts held by an NASD member and regulated by the NFA?

No. The Trading Activity Fee will only be assessed on transactions held in securities accounts regulated by NASD.

**Question 10:** Will the Trading Activity Fee be assessed on the settlement or exercise of options or security futures products?

Yes. If settlement results in the physical delivery of the underlying security or securities, the Trading Activity Fee will be assessed on the sale of the underlying security. However, options or security futures that are cash-settled and do not result in the sale of the underlying security or securities, do not result in a Trading Activity Fee assessment.

**Question 11:** Are options and futures involving narrow and broad based indexes exempt from the Trading Activity Fee?

Yes. As with the SEC Section 31 Fee, both options and futures on both narrow and broad based indexes are excluded from the Trading Activity Fee.

**Question 12:** Are American Depository Receipts (ADRs) included in the scope of the Trading Activity Fee?

Yes. Secondary market transactions in ADRs are subject to the Trading Activity Fee. However, conversions of ADRs to foreign ordinary shares are not subject to the Trading Activity Fee.

**Question 13:** Are Exchange Traded Funds ("ETF") and other structured products included in the scope of the Trading Activity Fee?

Yes. If an ETF or other structured product is subject to the SEC's Section 31 Fee, it will also be subject to the Trading Activity Fee. However, any transfer of underlying securities to create or redeem an ETF is not subject to the Trading Activity Fee.

**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 with the customer?

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

**Question 15:** Will a Trading Activity Fee be assessed on clearing related transactions such as Prime Broker, Step Outs, CNS "flips", CMTA trades, "GUS give-ups", etc.?

No. The scope of the Trading Activity Fee was designed to include only the initial execution of a transaction. Therefore, any back office or clearing

related transactions that serve only to facilitate the clearance and settlement of a previously executed transaction will not be assessed a Trading Activity Fee.

**Question 16:** Should the data be submitted to NASD by the clearing firm for the Trading Activity Fee?

Yes. Data should be submitted as monthly aggregates at the clearing firm level.

**Question 17:** Should the data be submitted on a trade by trade basis for the Trading Activity Fee?

No. Monthly aggregate data should be submitted to NASD by the 10th business day following the end of the month. This should include aggregate number of shares for stocks, aggregate number of contracts for options and aggregate number of round turn transactions for security future products.

**Question 18:** Should the data be calculated from the trade date?

Yes. The data should be calculated from the trade date (as opposed to the settlement date).

**Question 19:** Is the rate for the Trading Activity Fee based on principal value like the SEC Section 31 Fee?

No. The rate for the Trading Activity Fee is based on aggregate volumes. There will be a separate rate for share volume for stocks, contract volume for options and round turn transaction volume for futures.

**Question 20:** Will there be a minimum and maximum for the Trading Activity Fee similar to the Section 8 fee?

No. There will not be a minimum and maximum. The transactions are to be reported in aggregate not per trade.

**Question 21:** Will SEC Section 31 rounding rules apply for the Trading Activity Fee?

No. Rounding rules will not apply because the Trading Activity Fee is calculated and reported in aggregate.

**Question 22:** How will NASD verify the accuracy of members' self-reporting to ensure fair assessment of the Trading Activity Fee?

As part of NASD's regular cycle examinations of members, the monthly Trading Activity Fee reports will be audited against the books and records to ensure the accuracy of the reports. Discrepancies may result in disciplinary action, depending on the facts and circumstances.

## 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 Question 4 in the text of this *Notice* regarding transactions with non-NASD member broker/dealers.
3. See Securities Exchange Act Release No. 46417 (August 23, 2002), 67 FR 55893 (August 30, 2002) (SR-NASD-2002-99).
4. This is true as long as the underlying security is subject to the Trading Activity Fee.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### Schedule A to [the] NASD By-Laws

Assessments and fees pursuant to the provisions of Article VI of the By-Laws of [the] NASD shall be determined on the following basis.

#### Section [8] 2 – Member Regulation [Transaction] Fees

(a) NASD fee on cleared transactions. Each member shall be assessed a transaction charge of \$.0625 per 1,000 shares, with a minimum charge per side of \$.025 and a maximum charge per side of \$.46875 for each over-the-counter transaction with another member of the Association reportable through ACT in which the member acts either as an agent or a principal for the purchase and/or sale of equity securities.]

(b) SEC transaction fee. Each member shall be assessed a SEC transaction fee. The amount shall be determined by the SEC in accordance with Section 31 of the Act.]

(a) Recovery of cost of services. NASD shall, in accordance with this section, collect Member Regulation fees that are designed to recover the costs to NASD of the supervision and regulation of members, including performing examinations, processing of membership applications, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. NASD shall periodically review these revenues in conjunction with these costs to determine the applicable rate. NASD shall publish notices of the fees and adjustments to the assessment rates applicable under this section.

(b) Each member shall be assessed a Trading Activity Fee for the sale of covered securities.

(1) Covered Securities. For purposes of the rule, covered securities shall mean:

(i) All exchange registered securities wherever executed (other than bonds, debentures, and other evidence of indebtedness);

(ii) All other equity securities traded otherwise than on an exchange; and

(iii) All security futures wherever executed.

(2) Transactions exempt from the fee. The following shall be exempt from the Trading Activity Fee:

(i) Transactions in securities offered pursuant to an effective registration statement under the Securities Act of 1933 (except transactions in put or call options issued by the Options Clearing Corporation) or offered in accordance with an exemption from registration afforded by Section 3(a) or 3(b) thereof, or a rule thereunder;

(ii) Transactions by an issuer not involving any public offering within the meaning of Section 4(2) of the Securities Act of 1933;

(iii) The purchase or sale of securities pursuant to and in consummation of a tender or exchange offer;

(iv) The purchase or sale of securities upon the exercise of a warrant or right (except a put or call), or upon the conversion of a convertible security; and

(v) Transactions which are executed outside the United States and are not reported, or required to be reported, to a transaction reporting association as defined in Rule 11Aa3-1 and any approved plan filed thereunder.

NASD may exempt other securities and transactions as it deems appropriate.

(3) Fee Rates

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

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

(iii) 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.

(4) Reporting of Transactions. Members shall report to NASD the aggregate share, contract, and/or round turn volume of sales of covered securities in a manner as prescribed by NASD from time to time.

### **Section 3 – SEC Transaction Fee**

Each member shall be assessed an SEC transaction fee. The amount shall be determined by the SEC in accordance with Section 31 of the Act.



## Section [2] 4 – Fees

(a) Each member shall be assessed a fee of \$75.00 for the registration of each branch office, as defined in the By-Laws. Each member shall be assessed an annual fee for each branch office in an amount equal to the lesser of (1) \$75.00 per registered branch, or (2) the product of \$75.00 and the number of registered representatives and registered principals associated with the member at the end of [the Association] NASD's fiscal year.

(b) [The] NASD shall assess each member a fee of:

(1) \$85.00 for each initial Form U-4 filed by the member with [the] NASD for the registration of a representative or principal, except that the following discounts shall apply to the filing of Forms U-4 to transfer the registration of representatives or principals in connection with acquisition of all or a part of a member's business by another member:

Number of Registered Personnel Transferred	Discount
1,000—1,999	10%
2,000—2,999	20%
3,000—3,999	30%
4,000—4,999	40%
5,000 and over	50%

(2) \$40.00 for each initial Form U-5 filed by the member with [the] NASD for the termination of a registered representative or registered principal, plus a late filing fee of \$80.00 if the member fails to file the initial Form U-5 within 30 days after the date of termination;

(3) \$20.00 for each amended Form U-4 or Form U-5 filed by the member with [the] NASD;

(4) No change.

(5) \$10.00 for each fingerprint card submitted by the member to [the] NASD, plus any other charge that may be imposed by the United States Department of Justice for processing such fingerprint card; and

(6) No Change.

(c) through (k) No Change.

(1)(1) Unless a specific temporary extension of time has been granted, there shall be imposed upon each member required to file reports, as designated by this paragraph, a fee of \$100 for each day that such report is not timely filed. The fee will be assessed for a period not to exceed 10 business days. Requests for such extension of time must be submitted to [the Association] NASD at least three business days prior to the due date; and

(2) through (3) No Change.

### **Section [3] 5 – Elimination of Duplicate Assessments and Fees**

No Change to rule language.

### **Section [4] 6 – Assessments and Fees for New Members, Resigning Members and Successor Organizations**

(a) The assessment of a firm, which is not a member throughout [the Association] NASD's full calendar year from January 1 to December 31, shall be based upon the number of quarter years of membership. The proration for a new member shall include the quarter year in which the member is admitted to membership. The proration for a member which resigns shall include the quarter year in which the member's letter of resignation is received in [the Association] NASD's Executive Office.

(b) A member [which] that is a successor organization to a previous member or members shall assume the unpaid balance of the assessments of its predecessor or predecessors and its next assessment shall be determined, if applicable, upon the assessment data of its predecessors. Such successor member shall not be required to re-register branch offices and personnel of predecessor members or pay registration fees therefor. Whether a member is the successor organization to a previous member or members shall be determined by [the Association] NASD upon a consideration of the terms and conditions of the particular merger, consolidation, reorganization, or succession. A member [which] that has simply acquired the personnel and offices of another member under circumstances [which] that do not constitute the member a successor organization shall not be required to assume the unpaid assessments of the other member. Such non-successor member shall be required to re-register the branch offices and personnel acquired from the other member and pay applicable registration fees.

### **Section [5] 7 – Gross Revenue for Assessment Purposes**

No Change to rule language.

### **Section [6] 8 — Fees for Filing Documents Pursuant to the Corporate Financing Rule**

(a) There shall be a fee imposed for the filing of initial documents relating to any offering filed with [the] NASD pursuant to the Corporate Financing Rule equal to \$500 plus .01% of the proposed maximum aggregate offering price or other applicable value of all securities registered on an SEC registration statement or included on any other type of offering document (where not filed with the SEC), but shall not exceed \$30,500. The amount of filing fee may be rounded to the nearest dollar.

(b) There shall be an additional fee imposed for the filing of any amendment or other change to the documents initially filed with [the] NASD pursuant to the Corporate Financing Rule equal to .01% of the net increase in the maximum aggregate offering price or other applicable value of all securities registered on an SEC registration statement, or any related Rule 462(b) registration statement, or reflected on any Rule 430A prospectus, or included on any other type of offering document. However, the aggregate of all filing fees paid in connection with an SEC registration statement or other type of offering document shall not exceed \$30,500.

### **Section [7] 9 — Service Charge for Processing Extension of Time Requests**

(a) No Change.

(b) The service charge for processing each initial extension of time request and for all subsequent extension of time requests (1) involving the same transaction under Regulation T and/or (2) involving an extension of time previously granted pursuant to Rule 15c3-3(n) shall be \$2.00; provided, however, that the service charge shall be \$1.00 for extension of time requests filed electronically by members using [the Association] NASD's Automated Regulatory Reporting System.

### **Section [9] 10 – Subscription Charges for Firm Access Query System (FAQS)**

No Change to rule language.

### **Section [10] 11 – Request for Data and Publications**

No Change to rule language.

### **Section [11] 12 – Reserved**

No Change to rule language.

### **Section [12] 13 – Application and Annual Fees for Member Firms with Statutorily Disqualified Individuals**

(a) Any member firm seeking to employ or continuing to employ as an associated person any individual who is subject to a disqualification from association with a member as set forth in Article III, Section 4 of [the Association] NASD's By-Laws shall, upon the filing of an application pursuant to Article III, Section 3, paragraph (d) of [the Association] NASD's By-Laws, pay to [the Association] NASD a fee of \$1,500.00. Any member firm whose application filed pursuant to Article III, Section 3, paragraph (d) of [the Association] NASD's By-Laws results in a full hearing for eligibility in [the Association] NASD pursuant to the Rule 9640 Series, shall pay to [the Association] NASD an additional fee of \$2,500.00.

(b) Any member firm continuing to employ as an associated person any individual subject to disqualification from association with a member as set forth in Article III, Section 4 of [the Association] NASD's By-Laws shall pay annually to [the Association] NASD a fee of \$1,500.00 when such person or individual is classified as a Tier 1 statutorily disqualified individual, and a fee of \$1,000.00 when such person or individual is classified as a Tier 2 statutorily disqualified individual.

### **Section [13] 14 – Review Charge for Advertisement, Sales Literature, and Other Such Material Filed or Submitted**

There shall be a review charge for each and every item of advertisement, sales literature, and other such material, whether in printed, video or other form, filed with or submitted to [the Association] NASD, except for items that are filed or submitted in response to a written request from [the Association] NASD's Advertising Regulation Department issued pursuant to the spot check procedures set forth in [the Association] NASD's Rules as follows: (1) for printed material reviewed, \$75.00, plus \$10.00 for each page reviewed in excess of 10 pages; and (2) for video or audio media, \$75.00, plus \$10.00 per minute for each minute of tape reviewed in excess of 10 minutes.

Where a member requests expedited review of material submitted to the Advertising Regulation Department there shall be a review charge of \$500.00 per item plus \$25 for each page reviewed in excess of 10 pages. Expedited review shall be completed within three business days, not including the date the item is received by the Advertising Regulation Department, unless a shorter or longer period is agreed to by the Advertising Regulation Department. The Advertising Regulation Department may, in its sole discretion, refuse requests for expedited review.