

Notice to Members

NOVEMBER 2004

SUGGESTED ROUTING

Legal and Compliance
Operations Managers
Senior Management

KEY TOPICS

Section 1 of Schedule A to NASD By-Laws
Trading Activity Fee

GUIDANCE

Guidance on the Trading Activity Fee

SEC Approves Adjustments to the Trading Activity Fee

Executive Summary

On October 1, 2004, the Securities and Exchange Commission (SEC or Commission) approved an NASD rule filing amending the Trading Activity Fee (TAF) to reduce the TAF rate for covered equity securities, reduce the maximum per trade charge on covered equity securities, and assess the TAF on corporate debt securities that, under the Trade Reporting and Compliance Engine (TRACE) rules, are defined as "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and all municipal securities subject to Municipal Securities Rulemaking Board (MSRB) reporting requirements.¹ NASD will implement these changes as follows: (1) the TAF rate reduction and the reduction on the maximum per trade charge on covered equity securities will be effective November 1, 2004; and (2) the TAF will be assessed on "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and all municipal securities subject to MSRB reporting requirements effective April 1, 2005. NASD is delaying the effective date for debt securities until April 1 to allow member firms sufficient time to make programming changes to reflect the addition of two new categories of covered securities.

In this *Notice*, NASD is providing additional guidance with respect to certain equity security transactions and is seeking information from member firms concerning interpretive issues with respect to the operational aspects of applying the TAF to debt securities. NASD requests that members' interpretive questions be submitted in writing to NASD by no later than **January 1, 2005** so that NASD can provide the necessary guidance to ensure members are able to program their systems for debt securities by the April 1, 2005 effective date.

Included with the *Notice* is Attachment A, the text of the amendments to Schedule A to the NASD By-Laws and Attachment B, the revised form indicating the new equity rates.

Questions/Further Information

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

Background and Discussion

On December 29, 2003, NASD filed with the Commission a proposed rule change to adjust the TAF rate for covered equity securities, reduce the maximum per trade charge on covered equity securities, and assess the TAF on corporate debt securities that, under the TRACE rules, are defined as "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and on municipal securities subject to MSRB reporting requirements. The proposed rule change was published for notice and comment in the *Federal Register* on January 28, 2004.² On May 19, 2004, NASD filed with the Commission Amendment No. 1 and, at the same time, responded to comments submitted on the proposal. On September 30, 2004, NASD responded to further comments. The SEC approved the proposed rule change on October 1, 2004.

NASD is proceeding with its commitment to ensure that its new member regulatory structure, as approved by the SEC,³ remains revenue neutral to NASD and better aligns NASD's regulatory fees with its functions, efforts, and costs. As stated in the NASD By-Laws, NASD will analyze rates, volumes, and regulatory responsibilities periodically to sustain adequate funding levels for its member regulatory programs.⁴ Further, as part of a three-year phase-in plan included in the originally proposed pricing structure, NASD intends to reduce the revenue from the collection of the TAF by approximately 50 percent over the three-year period, offset by an increase in the Personnel Assessment. Thus, with this rule change, NASD is reducing the TAF rate on covered equity securities from the current rate of \$0.10 per 1,000 shares to \$0.075 per 1,000 shares.⁵ In addition, the maximum charge per trade under the TAF is being reduced from the current cap of \$10 per trade (based on 100,000 shares) to \$3.75 per trade (based on 50,000 shares).

Further, in response to previous comments from a number of members and other self-regulatory organizations about the scope of the TAF, NASD committed to analyzing whether debt transactions should be included under the TAF. NASD has reviewed reported volumes for TRACE-eligible securities and municipal securities in conjunction with NASD's current regulatory costs associated with the oversight of these securities. Based upon this review, NASD is assessing the TAF on TRACE-eligible securities and municipal securities at a rate of \$0.00075 per bond, with a maximum assessment of \$0.75 per trade (based on 1,000 bonds).

Implementation Date

NASD implemented the TAF rate reduction and the reduction on the maximum per trade charge on covered equity securities on November 1, 2004. In addition, NASD will begin assessing the TAF on "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and all municipal securities subject to MSRB reporting beginning on April 1, 2005. NASD is designating an effective date six months after SEC approval to allow member firms sufficient time to make programming changes to reflect the addition of two new categories of covered securities.

Guidance Regarding Certain Equity Transactions

NASD assesses the TAF on its members through clearing and self-clearing firms. As NASD stated in *Notice to Members 02-75*, the TAF is not assessed on transactions for non-member broker-dealers that clear through an NASD member unless that NASD member clearing firm is acting as executing broker in the transaction. NASD further stated in *Notice to Members 03-30* that NASD would consider a clearing firm to be acting as an executing broker if its correspondents utilized the clearing firm's order delivery system to send and execute orders under the clearing firm's MPID. NASD has received numerous questions concerning the application of this interpretation, particularly when the non-member broker-dealer does not use the clearing firm's system to route the order to another market center for execution. To further clarify, NASD considers the NASD member clearing firm to be the executing broker in any transaction where its non-member broker-dealer correspondent is only able to effect the trade by virtue of its clearing firm's membership with the applicable market center. For example, trades reported to ACT generally must be submitted to ACT by an NASD member. Therefore, the non-member correspondent would not be able to effect trades required to be reported to ACT without the use of the clearing firm's MPID that is granted to the clearing firm based on its NASD membership. Further, because the TAF is assessed on all covered securities transactions wherever executed, this interpretation also applies to similarly structured transactions effected on a national securities exchange.

Solicitation of Interpretive Questions Relating to Assessing the TAF on Debt

NASD encourages all interested parties to submit interpretive questions relating to the operational aspects of assessing the TAF on debt securities. Members have stated that there are certain operational issues that must be addressed with respect to assessing the TAF on debt securities prior to programming. While the TAF will be applied to debt in generally the same manner as covered equity securities, NASD recognizes that there may be certain issues unique to debt. To ensure all potential questions regarding differences in the application of the TAF between debt and equity securities are

adequately addressed, NASD is seeking to receive a comprehensive list of all such issues from industry participants. Questions must be received by NASD by **January 1, 2005**. Members and other interested parties can submit their questions using the following methods:

- ◆ Mailing the questions in hard copy to the address below; or
- ◆ E-mailing the questions to *pubcom@nasd.com*.

To help NASD process and review the questions more efficiently, persons submitting questions should use only one method. Questions sent by hard copy should be mailed to:

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

NASD staff will compile a list of those questions it believes will assist industry participants in complying with the amendments and publish these questions and answers in a subsequent *Notice to Members*.

Endnotes

- 1 Securities Exchange Act Rel. No. 50485 (Oct. 1, 2004), 69 FR 60445 (Oct. 8, 2004) (File No. SR-NASD-2003-201) (Order of Approval).
- 2 Securities Exchange Act Rel. No. 49114 (Jan. 22, 2004), 69 FR 4194 (Jan. 28, 2004) (Notice of Filing of Proposed Rule Change).
- 3 Securities Exchange Act Rel. No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (approving SR-NASD-2002-148) and Securities Exchange Act Rel. No. 47106 (Dec. 30, 2002), 68 FR 819 (Jan. 7, 2003) (approving SR-NASD-2002-99).
- 4 Specifically, NASD stated in the text of the TAF rule that it will “periodically review these revenues in conjunction with these costs to determine the applicable rate.” NASD By-Laws, Schedule A, Section 1(a).
- 5 NASD also will seek to reduce the TAF rate in 2005, if appropriate, after analyzing all relevant factors.
- 6 See question 6 in *Notice to Members 02-75*.
- 7 See question 3 in *Notice to Members 03-30*.

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ATTACHMENT A

Text of Rule Change

New language is underlined; deleted language is in brackets.

* * * * *

Schedule A to NASD By-Laws

* * * * *

Section 1 -- Member Regulatory Fees

- (a) No Change.
- (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:
 - (A) All exchange registered securities wherever executed ([other than bonds, debentures, and other evidence of indebtedness]except debt securities that are not TRACE-eligible securities);
 - (B) All other equity securities traded otherwise than on an exchange; [and]
 - (C) All security futures wherever executed[.];
 - (D) All "TRACE-eligible securities" wherever executed, provided that the transaction also is a "reportable TRACE transaction," as these terms are defined in Rule 6210; and
 - (E) All municipal securities subject to MSRB reporting requirements.
 - (2) Transactions exempt from the fee. The following shall be exempt from the Trading Activity Fee:
 - (A) No Change.
 - (B) Transactions by an issuer not involving any public offering within the meaning of Section 4(2) of the Securities Act of 1933 (except any "reportable TRACE transaction").
 - (C) through (I) No Change.

(J) Transactions in security futures held in futures accounts; [and]

(K) Transactions in exchange listed options effected by a member when NASD is not the designated options examining authority for that member[.]; and

(L) Proprietary transactions in TRACE-eligible securities by a firm that is a member of both NASD and a national securities exchange and that are effected in the firm's capacity as an exchange specialist or exchange market maker.

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

(3) Fee Rates*

(A) through (C) No Change.

(D) Each member shall pay to NASD a fee per bond for each sale of a covered TRACE-eligible security and/or municipal security.

* Trading Activity Fee rates are as follows: Each member shall pay to NASD [~~\$0.0001~~]\$0.000075 per share for each sale of a covered equity security, with a maximum charge of [~~\$10~~]\$3.75 per trade; \$0.002 per contract for each sale of an option; [and] \$0.04 per contract for each round turn transaction of a security future; and \$.00075 per bond for each sale of a covered TRACE-eligible and/or municipal security, with a maximum charge of \$0.75 per trade. In addition, if the execution price for a covered security is less than the Trading Activity Fee rate (~~[\$0.0001]~~\$0.000075 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.

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

(c) through (d) No Change.



Trading Activity Fee Self-Reporting Form

(Effective November 1, 2004)

Firm Name: _____

Mailing Address: _____

Check If New Address

B/D#: _____

Clearing#: _____

For the Month of: _____

Each member shall report sales of covered securities pursuant to the provisions of Section 2(b) [Trading Activity Fee] of Schedule A, Section 2 [Member Regulation Fees] to NASD's By-Laws. Covered securities include: 1) all exchange registered securities wherever executed (other than bonds, debentures, and other evidence of indebtedness), 2) all other equity securities traded otherwise than on an exchange, and 3) all security futures wherever executed.

Transaction Type	Aggregate Volume	Rate	Assessment Amount
1. Covered Equity Securities (under maximum ¹) - # of Shares	_____	\$0.000075	_____
2. Covered Equity Securities at maximum ¹) - # of Trades	_____	\$3.75	_____
3. Covered Option Contracts	_____	\$0.002	_____
4. Covered Future Securities (# of Contracts Traded on a Round Turn Basis)	_____	\$0.04	_____
Total Assessment			_____

Signature of Authorized Representative _____ Title _____

Print Name _____ Date/Telephone Number _____

E-Mail Address _____

Payment must be submitted with this form. The monthly form and payment are to be filed no later than 10 business days following the end of the month. The monthly form and payment may be submitted to NASD by either US mail or overnight Express mail as follows:

For U.S. 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
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 regarding the Trading Activity Fee or the report should be directed to NASD Finance, at (240) 386-5397.

1 There is a \$3.75 maximum on covered equity securities. All volumes under the maximum of 50,000 shares must be reported as the aggregate number of shares on Line 1. Share volume for any transactions of 50,000 shares or more should be excluded from Line 1 and would be reported as the aggregate number of trades on Line 2.