

August 21, 2002

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2002-99 – Revisions to By-Laws Regarding Gross Income Assessments and Personnel Assessments; Amendment No. 1

Dear Ms. England:

On July 23, 2002, NASD filed a proposed rule change to Schedule A to the NASD By-Laws to increase the rates assessed to member firms under the Personnel Assessment as well as to implement a simplified three-tiered flat rate for the Gross Income Assessment and eliminate current deductions and exclusions. NASD hereby submits Amendment No. 1 to SR-NASD-2002-99 (the “rule filing”). Enclosed as Exhibit 1 is a draft Notice, which incorporates the amendments described herein to the proposed rule language, to facilitate publication in the *Federal Register*, together with a 3-1/2” disk containing Exhibit 1 in Microsoft Word 7.0 format. The proposed rule language in Exhibit 1 replaces and completely supercedes the previously proposed rule language. The following is a description of the changes made pursuant to this Amendment No. 1 (new language is underlined and deleted text is bracketed).

1. NASD is amending current Section 1(a)(iv) (Assessments) on page 4 of the rule filing as follows:

with respect to members whose books, records and financial operations are examined by
[[the]] NASD, 0.125% of annual gross revenue from securities transactions executed on an
exchange.

The same change should be made to current Section 1(a)(iv) on page 17 of Exhibit 1 to the rule filing.

2. To facilitate publication in the *Federal Register*, the staff of the Division of Market Regulation has requested that NASD change the format of the tables that appear in the rule filing. NASD is amending the “Revised Rate Structure” table on page 10 of the rule filing as follows:

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Revised Rate Structure:

Gross FOCUS Revenue < or = to \$960 Thousand	Assessed Flat Fee of:	\$1,200
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Gross FOCUS Revenue > \$960 Thousand

Tiered Rate on Gross FOCUS Revenue:	Over \$1 Billion	0.014%
	> \$100 Million to \$1 Billion	0.029%
	< or = to \$100 Million	0.125%

Effective Rates at FOCUS Revenue Category Levels:	\$10 Billion	0.017%
	\$1 Billion	0.039%
	\$250 Million	0.067%
	\$100 Million	0.125%

The same change should be made to the "Revised Rate Structure" table on page 22 of Exhibit 1 to the rule filing.

In addition, NASD is amending the "Revised Rate Structure" table on page 11 of the rule filing as follows:

Revised Rate Structure:

Tiered-rate on registered reps:

> 25 registered reps	\$	65.00
6 to 25 registered reps	\$	70.00
1 to 5 registered reps	\$	75.00

The same change should be made to the "Revised Rate Structure" table on page 23 of Exhibit 1 to the rule filing.

If you have any questions concerning this amendment, please contact Patrice Gliniecki, Vice President and Deputy General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8014.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President and
Corporate Secretary

Enclosures

cc: Joseph P. Morra

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2002-99)

August , 2002

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by NASD Relating to
Gross Income Assessments and Personnel Assessments

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION’S STATEMENT OF THE TERMS OF
SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD is proposing to amend Schedule A of NASD By-laws to adjust its Member Regulation (including Enforcement) pricing structures to: (1) implement a three-tiered flat rate for the Gross Income Assessment (“GIA”) that would be applied to gross FOCUS revenue and would eliminate current deductions and exclusions; and (2) use the Personnel Assessment as a more prominent assessable base to fund Member Regulation activities.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Under the current structure, three types of fees and assessments are used to fund NASD's member regulatory activities: Regulatory Fee,³ Personnel Assessment, and Gross Income Assessment (GIA).⁴ The proposed restructuring is comprised of four important amendments: (1) eliminate the Regulatory Fee; (2) institute a new transaction-based Trading Activity Fee similar to the SEC's Section 31 Fee; (3) increase the rates assessed to member firms under the Personnel Assessment; and (4) implement a simplified three-tiered flat rate for the GIA and eliminate current deductions and exclusions.⁵ This rule filing is a part of a package of two separate yet related rule filings⁶ being submitted to the SEC as a result of a review of the overall NASD pricing structure⁷ and is intended to address the last two amendments to NASD pricing restructuring by increasing the rates assessed to member firms under the Personnel Assessment and implementing a simplified three-tiered flat rate for the GIA and eliminating current deductions and exclusions.

³ The Regulatory Fee is described in Section 8(a) of Schedule A to NASD By-Laws.

⁴ The Personnel Assessment and Gross Income Assessment are described in Section 1 of Schedule A to NASD By-Laws.

⁵ The changes resulting from the proposed restructuring would be revenue neutral.

⁶ The other rule filing is a proposed rule change to eliminate the Regulatory Fee and implement a Trading Activity Fee and to adjust the placement of the SEC Section 31 Transaction Fee in Schedule A (SR-NASD-2002-98).

⁷ NASD, in its pricing restructuring review, proposed changes to the Regulatory Fee in Special Notice to Members 02-09 and requested comments. NASD received a number of comments. In response to those comments, the proposal set forth in Special Notice to Members 02-09 is not being pursued. This rule filing replaces the changes previously proposed.

These fees assessed upon and paid by member firms are used by NASD 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. These amendments to this pricing structure are intended to serve the following purposes: (1) simplify NASD's fee structure; (2) ensure fairness in NASD's fee structure by assessing higher fees to those member firms that require more NASD regulatory services; (3) assess a transaction-based fee in a manner that, unlike the Regulatory Fee, does not influence where members choose to execute trades; (4) reduce the cyclical nature of the current NASD fee structure; and (5) eliminate NASD's reliance on funds generated from the Regulatory Fee on transactions executed through Nasdaq.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed 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 [2] 1 – Member Regulation Fees

(a) through (b) No Change.

[Section 1 – Assessments]

(c) Each member shall pay an annual Gross Income Assessment [composed of:] equal to the greater of \$1,200.00 or the total of:

[(a) An amount equal to the greater of \$1,200.00 or the total of:]

(1) [(i) 0.125% of annual gross revenue [from state and municipal securities transactions] less than or equal to \$100,000,000.00;

(2) [(ii) 0.125%] 0.029% of annual gross revenue [from other over-the-counter securities transactions,] greater than \$100,000,000.00 up to \$1,000,000,000.00; and

(3) [(iii) 0.125%] 0.014% of annual gross revenue [from U.S. Government securities transactions, and] greater than \$1,000,000,000.00.

[(iv) with respect to members whose books, records and financial operations are examined by the NASD, 0.125% of annual gross revenue from securities transactions executed on an exchange.]

Each member is to report annual gross revenue as defined in Section [7] 2 of this Schedule, for the preceding calendar year.

(d) Each member shall pay an annual Personnel Assessment equal to:

(1) \$75.00 per principal and each representative up to five principals and representatives as defined below;

(2) \$70.00 per principal and each representative for six principals and representatives up to twenty-five principals and representatives as defined below; or

(3) \$65.00 per principal and each representative for twenty-six or more principals and representatives as defined below.

[(b) An amount equal to \$10.00 for each principal and each] A principal or representative is defined as a principal or representative in the member's organization who is registered with [Association] NASD as of December 31st of the [current] prior fiscal year [of the Association, or

in the case of a new applicant for membership, for each principal and representative who is registered when the applicant's membership first becomes effective].

[(c) Members shall receive a credit against the annual assessment on gross income stated in paragraph (a) above as follows:

- (1) Portion of assessment > \$5,000—21%
- (2) Portion of assessment > \$25,000—3% additional
- (3) Portion of assessment > \$50,000—5% additional
- (4) Portion of assessment > \$100,000—3% additional]

Section [7] 2 – Gross Revenue for Assessment Purposes

[(a)] Gross revenue is defined for assessment purposes as total income as reported on FOCUS form Part II or IIA, [with the following exclusions:]

- [(1) Other income unrelated to the securities business;]
- [(2) Commodities income;]
- [(3) Advisory fees, investment management fees and finders' fees not directly involving the offering of securities; proxy fees; vault service fees; safekeeping fees; transfer fees; and fees for financial advisory services for municipalities;]
- [(4) Commissions derived from transactions executed on a registered national securities exchange or a foreign securities exchange (Note 1);]
- [(5) Profits or losses derived from transactions of which both the purchase and sale are executed on a registered national securities exchange, including arbitrage (Note 1): and]
- [(6) Profits and losses derived from transactions in certifications of deposit and commercial paper, which is defined to include drafts, bills of exchange, and bankers acceptances.]

[(b) In addition, members may deduct:]

[(1) Any commissions, concessions or other allowances paid to another member in connection with the execution or clearance of transactions included in reported revenue. For example, a member acting as a clearing agent for another member shall deduct net amounts allowed to the non-clearing member; and]

[(2) 25% of gross wrap fees charged to and received from customers and paid or allocated to investment managers or advisors.]

[(3) Interest and dividend expense but not in excess of related interest and dividend revenue or, alternatively, the member may deduct 40% of interest earned by the member on customer securities accounts; provided, however in addition, the member may deduct the first \$50,000 of net interest and dividend revenue.]

[Note 1: Income not subject to exclusion for members for whom the NASD is the designated examining authority.]

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Section [8] 7 – Fees for Filing Documents Pursuant to the Corporate Financing Rule

No Change to rule language.

Section [9] 8 – Service Charge for Processing Extension of Time Requests

No Change to rule language.

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

No Change to rule language.

Section [11] 10 – Request for Data and Publications

No Change to rule language.

Section [12] 11 – Reserved

No Change to rule language.

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

No Change to rule language.

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

No Change to rule language.

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II. SELF-REGULATORY ORGANIZATION’S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

The Regulatory Fee, Personnel Assessment, and Gross Income Assessment currently are used 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 proposed changes are revenue neutral and strive to better align NASD’s member regulatory fees with its functions, efforts and costs.

The amendments to this pricing structure are intended to serve the following purposes: (1) simplify NASD's fee structure; (2) ensure fairness in NASD's fee structure by assessing higher fees to those member firms that drive regulatory costs; (3) assess a transaction-based fee in a manner that, unlike the existing Regulatory Fee, does not influence where members choose to execute trades; (4) reduce the cyclical nature of the current NASD fee structure; and (5) eliminate NASD's reliance on funds generated from the Regulatory fee on transactions executed through Nasdaq.

NASD's membership population varies greatly with regard to factors that drive the cost of required regulation. Historically, member regulatory fees were derived primarily from industry revenues and Nasdaq transactions, while NASD derived minimal fees from the registration of member firm personnel. Analysis revealed that the number of registered persons serves as an effective proxy in determining the frequency of certain types of regulatory efforts, and therefore regulatory costs. Therefore, as before, the three critical factors used to measure regulatory cost for NASD member firms are overall size of the member firm, level of trading activity and number of registered representatives. However, the weight from each, as well as the benchmark used to measure industry revenues and transactions, has been shifted under the proposed amendments to better link the fees assessed under these factors with NASD's costs.

Gross Income Assessment (GIA)

The current GIA is assessed on a member firm's gross FOCUS revenues less various exclusions and deductions. The allowable exclusions and deductions have grown to the point where they totaled over 60% of gross FOCUS revenues in 2001. Member firms are assessed 0.125% on the net assessable FOCUS revenue that converts into a .0355% effective rate on gross

FOCUS revenues. Member firms having gross FOCUS revenues less than or equal to \$960,000 are assessed at a flat rate of \$1,200.

Under the current fee structure for the GIA, the amount of revenue received by NASD is subject to unpredictable swings due to deductions and exclusions taken by member firms. The exclusions and deductions include interest expense, investment management fees, exchange revenue, and unrelated revenues. In 2001, gross FOCUS revenue increased by 30%, yet the total assessment only increased by 15% due to a disproportionate increase in exclusions and deductions, primarily in interest expense. The proposed amendments to the pricing structure are intended to improve the standardization, consistency and uniformity in which the GIA is assessed on and paid by member firms.

The proposed solution is similar to that employed by the New York Stock Exchange. The rate would be applied to the gross FOCUS revenue with deductions and exclusions eliminated. Given the diversity and size of NASD member firms, NASD proposes the following three-tiered rate structure:

Revised Rate Structure:		
Gross FOCUS Revenue < or = to \$960 Thousand	Assessed Flat Fee of:	\$1,200
Gross FOCUS Revenue > \$960 Thousand		
Tiered Rate on Gross FOCUS Revenue:	Over \$1 Billion	0.014%
	> \$100 Million to \$1 Billion	0.029%
	< or = to \$100 Million	0.125%
Effective Rates at FOCUS Revenue Category Levels:	\$10 Billion	0.017%
	\$1 Billion	0.039%
	\$250 Million	0.067%
	\$100 Million	0.125%

Small member firms with gross FOCUS revenues less than or equal to \$960,000 would continue to be assessed a flat fee of \$1,200. As outlined above, all other member firms will be

assessed a tiered rate based on their gross FOCUS revenues. The higher the gross FOCUS revenue, the lower the effective rate.

This type of rate structure will allow for greater equity among member firms because each member firm will be assessed on the same revenue base. Additionally, the new rate structure will simplify the process because member firms will report only gross FOCUS revenue as currently done on FOCUS Form Part II or IIA and will no longer need to report deductions and exclusions.

Personnel Assessment

The current Personnel Assessment is a minimal fee of \$10 per registered representative that generates only 4% of total member regulatory fees and inadequately supports NASD's member regulatory costs. The number of registered representatives per firm is a fair and representative measure of the cost of member regulatory activities, yet has not been used as a greater basis for the assessment of fees. Additionally, based on the current fee structure, some firms with a disproportionately large number of registered representatives yet lower FOCUS revenues are avoiding the payment of the cost of regulating member firms through the payment of NASD fees.

As part of this proposal, the Personnel Assessment will become a more prominent assessable base for the funding of member regulatory activities. Given the vast size differential of NASD member firms, NASD proposes the following three-tiered rate structure:

Revised Rate Structure:

Tiered-rate on registered reps:		
> 25 registered reps	\$	65.00
6 to 25 registered reps	\$	70.00
1 to 5 registered reps	\$	75.00

Phase-In

NASD's overall proposal will be revenue neutral to NASD. However, due to the link of revenues to regulatory services provided, there will be effects, both negative and positive, on individual member firms. To minimize the impact on member firms, the restructuring of fees will be phased in over a three-year period. Specifically, for the GIA, any negative or positive variances experienced by firms will be phased in at a rate of 33% in Year 1, 67% in Year 2 and 100% in Year 3. Also, the Personnel Assessment, which will be increased to cover the reduction in the Trading Activity Fee, will be phased-in at a rate of 33% in Year 1, 67% in Year 2 and 100% in Year 3. Based upon a review of the majority of NASD's small member firms, the net increase of fees will average approximately \$100 in Year 1.

Additionally, NASD will continue to reduce these fees through rebates to the member firms in connection with the proceeds raised from the sale of Nasdaq. NASD will continue to use a portion of these rebates to eventually reduce the minimum GIA amount from \$1,200 to \$600. The remaining balance and any additional discretionary rebates will be used to further reduce any negative impact experienced by the member firms as a result of this proposal.

(2) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act,⁸ which requires, among other things, that NASD's rules provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which NASD operates or controls. Moreover, the level of the fee is reasonable because it relates to the recovery of the costs of supervising and regulating members. NASD believes that the majority of the small member firms would not be

⁸ 15 U.S.C. 78o-3(b)(5).

impacted by the change in the GIA's structure since over half of NASD's member firm population has gross FOCUS revenues of less than \$960 thousand.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received on the current proposal.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

The proposed rule change fees will become operational on January 1, 2003.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect

to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Jonathan G. Katz
Secretary

⁹ 17 CFR 200.30-3(a)(12).