

August 20, 2004

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-2004-129 – Proposed Rule Change Relating to Section 3 of Schedule A to the NASD By-Laws; Filed for Immediate Effectiveness**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Kathleen A. O'Mara, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8071; e-mail kathleen.omara@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Marc Menchel
Executive Vice President
and General Counsel

Enclosures

cc: Michael Gaw

File No. SR-NASD-2004-129
Consists of 36 Pages
August 20, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(3) of the Securities Exchange Act of 1934 (“Act”),¹ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend Section 3 of Schedule A to the NASD By-Laws to remove references to the SEC. In addition, NASD is filing portions of a Notice to Members relating to interpretations of Section 3 of Schedule A to the NASD By-Laws. NASD also is filing two self-reporting forms that are to be used by members to report trade data that is not captured by NASD’s trade reporting systems. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are bracketed.

* * * * *

Schedule A to NASD By-Laws

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

Section 1 through 2 – No Change.

Section 3 – [SEC] Regulatory Transaction Fee

Each member shall be assessed a[n SEC] regulatory transaction fee. The amount shall be determined [by the SEC] periodically in accordance with Section 31 of the Act.

* * * * *

(b) Not applicable.

(c) Not applicable.

¹ 15 U.S.C. 78s(b)(3).

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Governors of NASD (“Board”) and authorized for filing with the SEC pursuant to a delegation of authority granted by the Board at the NASD’s Board meeting on January 23, 2003, to the General Counsel of NASD Regulatory Policy and Oversight (or his officer designee) to file, without further specific Board authorization, proposed administrative, technical, conforming, and non-substantive rule changes to amend NASD rules (the “Delegation of Authority”). Counsel for The Nasdaq Stock Market and NASD Dispute Resolution were provided an opportunity to consult with respect to the general Delegation of Authority, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The staff will advise the Board of any action taken pursuant to the Delegation of Authority. Section 1(a)(ii) of Article VII of NASD’s By-Laws permits the Board of Governors of NASD to adopt amendments to NASD Rules without recourse to the membership for approval. No other action by NASD is necessary for the filing of the proposed rule change.

As further discussed below, NASD is filing the proposed rule change for immediate effectiveness.

(b) Questions regarding this rule filing may be directed to Kathleen A. O’Mara, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8071.

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Section 31 of the Act requires that NASD, as a national securities association, and the national securities exchanges pay transaction fees and assessments to the Commission that are

designed to recover the costs related to the government's supervision and regulation of the securities markets and securities professionals. On June 28, 2004, the Commission established new procedures governing the calculation, payment, and collection of fees and assessments on securities transactions owed by national securities exchanges and associations to the Commission pursuant to Section 31 of the Act.² The new procedures became effective on August 6, 2004. In accordance with the new procedures, NASD must now provide the Commission with trade data, which the Commission will use to calculate the amount of fees and assessments due by NASD. Accordingly, the calculation of fees and assessments owed by NASD pursuant to Section 31 of the Act will now be performed exclusively by the Commission. To recover the costs of NASD's Section 31 obligation, NASD assesses a transaction fee on its member firms under Section 3 of Schedule A to the NASD By-Laws.

In response to the new procedures adopted by the Commission and interpretive guidance provided in the Adopting Release, NASD is filing with the Commission: (1) a proposed rule change to amend Section 3 of Schedule A to the NASD By-Laws to remove references to the SEC; (2) portions of a forthcoming Notice to Members relating to interpretations of Section 3 of Schedule A; and (3) two self-reporting forms that are to be used by members to report trade data that is not captured by NASD's trade reporting systems.

Pursuant to Section 3 of Schedule A, NASD assesses a transaction fee on its member firms, the amount of which is determined periodically in accordance with Section 31 of the Act, to recover the costs of NASD's Section 31 obligation. The current title of Section 3 of Schedule

² See Final Rule Regarding Collection Practices Under Section 31, Securities Exchange Act Release No. 49928 (June 28, 2004), 69 FR 41059 (July 7, 2004) ("Adopting Release").

A is “SEC Transaction Fee,” and the text of Section 3 of Schedule A states: “[e]ach member shall be assessed an SEC transaction fee. The amount shall be determined by the SEC in accordance with Section 31 of the Act.” The current title and text of Section 3 of Schedule A were filed with the Commission for notice and review in 2002.³

NASD is proposing to amend Section 3 of Schedule A in response to statements made by the SEC in its Adopting Release that “it is misleading to suggest that a customer or [a self-regulatory organization] member incurs an obligation to the Commission under Section 31.”⁴ While NASD notes that the Commission has previously reviewed Section 3, formerly Section 8, of Schedule A to the NASD By-Laws and deemed it to be consistent with the Act,⁵ to avoid any possible confusion as discussed in the Adopting Release, NASD is now amending Section 3 of Schedule A to delete any references to the SEC. In addition, in conformity with the Adopting Release, NASD is proposing to refer to the transaction fee as a “Regulatory Transaction Fee” in the title and text of Section 3 of Schedule A. The transaction fee assessed by NASD will

³ See Securities Exchange Act Release No. 46168 (July 8, 2002), 67 FR 46558 (July 15, 2002) (notice of filing and immediate effectiveness of SR-NASD-2002-65); Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (order approving SR-NASD-2002-148).

⁴ See Securities Exchange Act Release No. 49928, 69 FR 41059, 41072.

⁵ See Securities Exchange Act Release No. 38133 (January 7, 1997), 62 FR 1940 (January 14, 1997) (notice of filing and immediate effectiveness of SR-NASD-96-57); Securities Exchange Act Release No. 46168 (July 8, 2002), 67 FR 46558 (July 15, 2002) (notice of filing and immediate effectiveness of SR-NASD-2002-65); Securities Exchange Act Release No. 46416 (August 23, 2002), 67 FR 55901 (August 30, 2002) (notice of filing and immediate effectiveness of SR-NASD-2002-98); Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (order approving SR-NASD-2002-148).

continue to be set, as it is today, in accordance with Section 31 of the Act.⁶ Therefore, NASD is not amending the reference to Section 31 in Section 3 of Schedule A to the NASD By-Laws.

Though the requirements of Section 31, including the new procedures established by the Commission, apply directly to NASD and the national securities exchanges, and not their membership, the requirements will affect the obligations of member firms under Section 3 of Schedule A to the NASD By-Laws. Therefore, NASD is issuing a Notice to Members to inform member firms of the new procedures relating to Section 31 and to remind member firms of their continuing obligation to pay the transaction fees assessed by NASD so that it can recover the costs of its Section 31 obligation. The staff believes that certain provisions in the forthcoming Notice may constitute interpretations of Section 3 of Schedule A to the NASD By-Laws that, due to their nature, should be filed as a proposed rule change. The provisions in question relate to: (1) members' obligation to self report securities sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security and where consideration is given for the securities; (2) members' obligation to submit certain self-reporting forms and applicable payments to NASD by certain deadlines; (3) the manner in which members should use rounding to calculate the transaction fees on self-reported trades; and (4) guidance regarding the appropriate terminology when referring to the transaction fees assessed by NASD under Section 3 of Schedule A to the NASD By-Laws. The relevant provisions of the Notice to Members are as follows:

⁶ NASD also is amending Section 3 of Schedule A to reflect that the applicable fee rate assessed by NASD is periodically adjusted in accordance with Section 31. In the past, NASD has notified members, through Member Alerts or other means, of any periodic adjustments to the fee rate made by the Commission. NASD will continue to notify members of any such adjustments in the future since NASD seeks to recover the costs of its Section 31 obligation from its members.

As adopted, the new procedures require NASD to tabulate aggregate sales volume based on information reported to its trade reporting systems and to submit this data to the SEC on SEC Form R31 on a monthly basis. Pursuant to SEC Rule 31(b)(1), NASD is required to submit to the SEC a completed Form R31 within ten business days after the end of each month. NASD currently has two trade reporting systems for purposes of Rule 31 under the Exchange Act – the Automated Confirmation Transaction Service (ACT) and the Trade Reporting and Confirmation Service (TRACS). In addition, NASD is required to compile and submit, through Form R31, similar trading activity information on trades that are not captured by ACT or TRACS.

Specifically, NASD is required to submit the aggregate dollar amount of covered sales that: (1) occurred by or through a member otherwise than on a national securities exchange; (2) had a “charge date”¹⁰ in the month of the report; and (3) NASD captured in its trade reporting systems. NASD also is required to submit trade data to the SEC on covered sales that are not captured on either ACT or TRACS, which would include covered sales in odd lots, covered sales resulting from the exercise of options settled by physical delivery and not listed or traded on a national securities exchange, and covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security (hereinafter referred to as away from the market sales).¹¹

Currently, NASD obtains trade data on covered sales in odd lots and covered sales resulting from the exercise of options settled by physical delivery and not listed or traded on a national securities exchange through a self-reporting mechanism, but trade data on away from the market sales is not captured in NASD’s trade reporting systems or through a self-reporting mechanism. Moreover, NASD previously had not included away from the market sales in its calculation of the transaction fees owed to the SEC under Section 31 based upon SEC guidance that such transactions were not subject to Section 31 fees.¹² In the Adopting Release, however, the SEC stated that it now believes that such transactions are subject to Section 31 fees where consideration is given for the securities. Therefore, as explained in greater detail below, NASD will begin seeking trade information on these transactions from members through self reporting so that it can satisfy its reporting obligation under the new SEC procedures.

SEC Rule 31T authorizes the SEC to collect trade data on all covered sales retroactively for each of the months September 2003 to June 2004, inclusive. Accordingly, the Rule as written requires NASD to submit trade data on away from the market sales for each of the months in the September 2003 to June 2004 period. Such an approach would require members to retroactively self report such transactions to NASD. NASD believes that requesting historical information from member firms on away from the market sales for the period from September 2003 to June 2004 is unduly burdensome on members.

Therefore, NASD has sought an exemption from the SEC with respect to NASD's retroactive reporting obligation. Consequently, in light of NASD's pending exemption request, members will not have to review transactions between September 2003 and June 2004 to identify away from the market sales for that period.¹³ However, NASD will begin reporting away from the market sales effective July 2004 and for each month thereafter. To allow members more time to review their July 2004 transactions to identify away from the market sales for that month, NASD also has sought an exemption from the SEC so that NASD can report away from the market sales for July 2004 in the Form R31 that is due on September 15, 2004. The exemptions sought by NASD are intended to give member firms more time to make the necessary changes to their systems to facilitate the self reporting of away from the market sales.

* * *

Obligations of Member Firms

To recover the costs of NASD's Section 31 obligation, NASD assesses a transaction fee on its member firms under Section 3 of Schedule A to the NASD By-Laws, the amount of which is set in accordance with Section 31 of the Exchange Act.¹⁴ As noted above, the new SEC procedures relating to Section 31 do not directly affect the obligation of member firms to pay the transaction fees assessed by NASD. NASD anticipates that the impact of SEC's new procedures on its members will be minimal. NASD will continue to bill members for covered securities transactions that are reported through ACT on a monthly basis, as it does today. In addition, NASD will bill members for transactions reported through TRACS. Nonetheless, members should be aware that the new procedures adopted by the SEC will affect NASD practices and, pursuant to such practices, member's reporting obligations. Specifically, member firms now are required to self report away from the market sales¹⁵ – this is in addition to the currently self-reported covered sales in odd-lot transactions and covered sales resulting from the exercise of over-the-counter (OTC) options that settle by physical delivery.

In accordance with guidance provided in the SEC's Adopting Release, NASD has revised its existing self-reporting form so that members can report, in addition to odd-lot transactions and exercises of OTC options that settle by physical delivery, away from the market sales. In addition, NASD has created an Interim Self-Reporting Form to facilitate members' reporting of certain away from the market sales. NASD also will now require that trade data and applicable payments be received by NASD by the seventh calendar day of each month subsequent to the trade period covered on the report.¹⁶ Currently, members have until the tenth calendar day of each month to submit the trade data and payments to NASD. However, given the NASD's obligation to process the trade data in a shorter timeframe (NASD is required to submit the

trade data to the SEC within ten business days after the end of each month), NASD is requiring members to provide the trade data and payments by the seventh calendar day of each month, beginning in September 2004.

Members must use the Interim Self-Reporting Form that is attached to this *Notice* to self report covered sales of odd-lots and OTC exercised options as well as away from the market sales for the August 2004 trade-reporting period. In addition, members must use the Interim Self-Reporting Form to report away from the market sales for the July 2004 trade-reporting period.¹⁷ The Interim Self-Reporting Form and applicable payments must be received by NASD by September 7, 2004. The Interim Self-Reporting Form will be used once only in September 2004.

To self report covered sales, including away from the market sales, for the September 2004 trade-reporting period and for each month thereafter, members must use the Permanent Self-Reporting Form, which also is attached to this *Notice*. The Permanent Self-Reporting Form becomes effective on October 1, 2004. The first Permanent Self-Reporting Form and applicable payments must be received by NASD by October 7, 2004. NASD reminds firms to print and retain blank copies of the Permanent Self-Reporting Form for future use.

NASD also reminds firms of their continuing obligation to ensure the accuracy and timeliness of information reported to NASD, including real-time trade information reported to ACT and TRACS and self-reported trade information. Moreover, because NASD will rely on self-reported data from member firms to complete Part III of SEC Form R31, it is imperative that firms submit accurate trade data to NASD on a timely basis on covered sales of odd-lot transactions and exercises of OTC options that settle by physical delivery, as well as away from the market sales.

Rounding and Disclosure of Transaction Fees

Currently, members calculate the transaction fees on self-reported trades by: (1) multiplying the aggregate dollar amount of self-reported covered sales by the fee rate; (2) truncating the resulting amount at the fifth place after the decimal point; and (3) rounding up to the next cent, if there is any remainder. While firms need not pass transaction fees on to their customer, it is NASD's understanding that such fees are frequently passed by broker-dealers on to their customers on a trade-by-trade basis.¹⁸ In addition, NASD understands that reconciling the amounts billed by NASD and the amounts collected by member firms has been difficult from a member firm perspective, resulting in overages at some broker-dealer firms, in part due to the practice of routinely rounding up to the next cent. To more accurately reconcile the amount that NASD bills its members and the amount collected by members from their customers, members should no longer solely round up when there is a

remainder after truncating the resulting amount. Rather, if there is any remainder, members should alternate between rounding up and rounding down to the next cent.

With respect to the disclosure of the transaction fees that members pass on to their customers, the SEC does not believe that it is appropriate for members to refer to the fee assessed by NASD as “Section 31 Fees” or “SEC Fees.”¹⁹ Therefore, as noted by the SEC, members should refrain from labeling the fees as such to avoid any confusion by their customers.²⁰

¹⁰ The charge date for trades reported in Parts II and III of Form R31 is the trade date, with one exception. The charge date for covered sales resulting from the exercise of over-the-counter options that settle by physical delivery is the exercise date. In addition, NASD has sought an exemption from the SEC to permit the charge date for “as-of” trades reported by NASD in Form R31 to be the trade report date.

¹¹ See Securities Exchange Act Release No. 49928, 69 FR 41059, 41063.

¹² See Final Rule Regarding Securities Transactions Exempt From Transaction Fees, Securities Exchange Act Release No. 38073 (December 23, 1996), 61 FR 68590, 68592 n.27 (December 30, 1996).

¹³ In the event the SEC does not grant the requested exemption to NASD, NASD will require its members to report such information to it and will promptly inform its members of such fact and of the manner in which to report the information. At this time, however, NASD is proceeding under the assumption that such exemption will be granted.

¹⁴ Pursuant to the Investor and Capital Markets Fee Relief Act, the SEC is required to make periodic adjustments to the Section 31 fee rates. As noted above, the current fee rate is set at \$23.40 per million.

¹⁵ As stated in the Adopting Release, a gift of a security without consideration is not a “sale” for purpose of Sections 31(c) of the Exchange Act, and is not subject to Section 31 fees. Therefore, member firms are not required to self report transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security if no consideration is given for the securities.

¹⁶ If the seventh calendar day falls on a weekend or a public holiday, the report must be received by NASD on the first business day following the weekend or holiday.

¹⁷ The Interim Self-Reporting Form includes two tables for purposes of reporting away from the market sales for the July and August 2004 trade-reporting periods. Members must use the first table in the form to report away from the market sales for transactions occurring in August 2004. Members must use the second table in the form to report only away from the market sales and only for the month of July 2004.

¹⁸ See Letter from Ernest A. Pittarelli, Chairman, Securities Industry Association Operations Committee, to Jonathan G. Katz, Secretary, SEC, dated March 5, 2004.

¹⁹ Securities Exchange Act Release No. 49928, 69 FR 41059, 41072.

²⁰ NASD is filing a proposed rule change with the SEC to amend, among other things, the title of Section 3 of Schedule A to the NASD By-Laws from “SEC Transaction Fee” to “Regulatory Transaction Fee.”

Finally, NASD has revised its Permanent Self-Reporting Form so that going forward members can report covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security, with the exception of securities

transactions where no consideration is given for the securities. NASD previously had not assessed a transaction fee on such sales because the Commission had stated that transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security were not subject to Section 31 fees.⁷ As stated in the Adopting Release, however, the Commission now believes that such securities sales are subject to Section 31 fees where consideration is given for the securities, and, therefore, such covered sales must be reported to the Commission.⁸ Accordingly, NASD is making conforming changes to the Permanent Self-Reporting Form, and it is filing the form with the Commission. The Permanent Self-Reporting Form will become effective on October 1, 2004, and members must use this form to report covered sales for the month of September 2004 and for each month thereafter. As discussed below, NASD is using a different self-reporting form for the collection of certain trade data.

NASD has created an Interim Self-Reporting Form to facilitate the collection of trade data and payments for covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security for the months of July and August 2004. The Interim Self-Reporting Form will be used once only in September 2004. Members

⁷ See Final Rule Regarding Securities Transactions Exempt From Transaction Fees, Securities Exchange Act Release No. 38073 (December 23, 1996), 61 FR 68590, 68592 n.27 (December 30, 1996).

⁸ Pursuant to SEC Rule 31T, as written, NASD is obligated to submit trade data on such covered sales for each of the months in the September 2003 to June 2004 period, but NASD has sought an exemption from the SEC with respect to NASD's retroactive reporting obligation. NASD has requested an exemption so that it would not be obligated to report such covered sales on a retroactive basis for the September 2003 to June 2004 period, and it would not be obligated to report to the SEC such covered sales for the month of July 2004 until the September 15, 2004 reporting date.

must use the Interim Self-Reporting Form to report, for the month of August 2004, covered sales in odd-lot transactions, covered sales resulting from the exercise of over-the-counter options that settle by physical delivery, and covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security. Members also must use the Interim Self-Reporting Form to report covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security for the month of July 2004. NASD must receive the Interim Self-Reporting Form, including any applicable payment, by September 7, 2004. NASD also is filing the Interim Self-Reporting Form with the Commission.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed changes to Section 3 of Schedule A to the NASD By-Laws and to the manner by which member firms refer to the fee assessed by NASD when passing it on to their customers is consistent with the protection of investors and the public interest in that it will avoid any confusion by members and their customers. In addition, the proposed rule change, including the portions of the Notice that are intended to assist members in complying with Section 3 of Schedule A to the NASD By-Laws, is consistent with Section 15A(b)(5) of the Act,¹⁰ which

⁹ 15 U.S.C. 78o-3(b)(6).

¹⁰ 15 U.S.C. 78o-3(b)(5).

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 that NASD operates or controls.

4. 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.

5. 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.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3) of the Act¹¹ and Rule 19b-4(f)(6) thereunder,¹² in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days (or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest) after the date of this filing. NASD requests that the Commission waive the five-day pre-filing

¹¹ 15 U.S.C. 78s(b)(3)(A).

¹² 17 CFR 240.19b-4(f)(6).

notice requirement specified in Rule 19b-4(f)(6)(iii) under the Act.¹³ In addition, NASD requests that the Commission waive the 30-day operative delay set forth in Rule 19b-4(f)(6)(iii),¹⁴ so that NASD can satisfy its obligation under Section 31 of the Act on a timely basis.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD

BY: _____
Marc Menchel, Executive Vice President and
General Counsel, Regulatory Policy and Oversight

August 20, 2004

¹³ 17 CFR 240.19b-4(f)(6)(iii).

¹⁴ Id.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2004-129)

August , 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Section 3 of Schedule A to the NASD By-Laws

Pursuant to Section 19(b)(3) 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. NASD has designated the proposed rule change as constituting a “non-controversial” rule change pursuant to Rule 19b-4(f)(6) under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. 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 Section 3 of Schedule A to the NASD By-Laws to remove references to the SEC. In addition, NASD is filing portions of a Notice to Members relating to interpretations of Section 3 of Schedule A to the NASD By-Laws. NASD also is filing two self-

¹ 15 U.S.C. 78s(b)(3).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

reporting forms that are to be used by members to report trade data that is not captured by NASD's trade reporting systems. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are bracketed.

* * * * *

Schedule A to NASD By-Laws

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

Section 1 through **2** – No Change.

Section 3 – [SEC] Regulatory Transaction Fee

Each member shall be assessed a[n SEC] regulatory transaction fee. The amount shall be determined [by the SEC] periodically in accordance with Section 31 of the Act.

* * * * *

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

Section 31 of the Act requires that NASD, as a national securities association, and the national securities exchanges pay transaction fees and assessments to the Commission that are

designed to recover the costs related to the government's supervision and regulation of the securities markets and securities professionals. On June 28, 2004, the Commission established new procedures governing the calculation, payment, and collection of fees and assessments on securities transactions owed by national securities exchanges and associations to the Commission pursuant to Section 31 of the Act.⁴ The new procedures became effective on August 6, 2004. In accordance with the new procedures, NASD must now provide the Commission with trade data, which the Commission will use to calculate the amount of fees and assessments due by NASD. Accordingly, the calculation of fees and assessments owed by NASD pursuant to Section 31 of the Act will now be performed exclusively by the Commission. To recover the costs of NASD's Section 31 obligation, NASD assesses a transaction fee on its member firms under Section 3 of Schedule A to the NASD By-Laws.

In response to the new procedures adopted by the Commission and interpretive guidance provided in the Adopting Release, NASD is filing with the Commission: (1) a proposed rule change to amend Section 3 of Schedule A to the NASD By-Laws to remove references to the SEC; (2) portions of a forthcoming Notice to Members relating to interpretations of Section 3 of Schedule A; and (3) two self-reporting forms that are to be used by members to report trade data that is not captured by NASD's trade reporting systems.

Pursuant to Section 3 of Schedule A, NASD assesses a transaction fee on its member firms, the amount of which is determined periodically in accordance with Section 31 of the Act, to recover the costs of NASD's Section 31 obligation. The current title of Section 3 of Schedule

⁴ See Final Rule Regarding Collection Practices Under Section 31, Securities Exchange Act Release No. 49928 (June 28, 2004), 69 FR 41059 (July 7, 2004) ("Adopting Release").

A is “SEC Transaction Fee,” and the text of Section 3 of Schedule A states: “[e]ach member shall be assessed an SEC transaction fee. The amount shall be determined by the SEC in accordance with Section 31 of the Act.” The current title and text of Section 3 of Schedule A were filed with the Commission for notice and review in 2002.⁵

NASD is proposing to amend Section 3 of Schedule A in response to statements made by the SEC in its Adopting Release that “it is misleading to suggest that a customer or [a self-regulatory organization] member incurs an obligation to the Commission under Section 31.”⁶ While NASD notes that the Commission has previously reviewed Section 3, formerly Section 8, of Schedule A to the NASD By-Laws and deemed it to be consistent with the Act,⁷ to avoid any possible confusion as discussed in the Adopting Release, NASD is now amending Section 3 of Schedule A to delete any references to the SEC. In addition, in conformity with the Adopting Release, NASD is proposing to refer to the transaction fee as a “Regulatory Transaction Fee” in the title and text of Section 3 of Schedule A. The transaction fee assessed by NASD will

⁵ See Securities Exchange Act Release No. 46168 (July 8, 2002), 67 FR 46558 (July 15, 2002) (notice of filing and immediate effectiveness of SR-NASD-2002-65); Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (order approving SR-NASD-2002-148).

⁶ See Securities Exchange Act Release No. 49928, 69 FR 41059, 41072.

⁷ See Securities Exchange Act Release No. 38133 (January 7, 1997), 62 FR 1940 (January 14, 1997) (notice of filing and immediate effectiveness of SR-NASD-96-57); Securities Exchange Act Release No. 46168 (July 8, 2002), 67 FR 46558 (July 15, 2002) (notice of filing and immediate effectiveness of SR-NASD-2002-65); Securities Exchange Act Release No. 46416 (August 23, 2002), 67 FR 55901 (August 30, 2002) (notice of filing and immediate effectiveness of SR-NASD-2002-98); Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (order approving SR-NASD-2002-148).

continue to be set, as it is today, in accordance with Section 31 of the Act.⁸ Therefore, NASD is not amending the reference to Section 31 in Section 3 of Schedule A to the NASD By-Laws.

Though the requirements of Section 31, including the new procedures established by the Commission, apply directly to NASD and the national securities exchanges, and not their membership, the requirements will affect the obligations of member firms under Section 3 of Schedule A to the NASD By-Laws. Therefore, NASD is issuing a Notice to Members to inform member firms of the new procedures relating to Section 31 and to remind member firms of their continuing obligation to pay the transaction fees assessed by NASD so that it can recover the costs of its Section 31 obligation. The staff believes that certain provisions in the forthcoming Notice may constitute interpretations of Section 3 of Schedule A to the NASD By-Laws that, due to their nature, should be filed as a proposed rule change. The provisions in question relate to: (1) members' obligation to self report securities sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security and where consideration is given for the securities; (2) members' obligation to submit certain self-reporting forms and applicable payments to NASD by certain deadlines; (3) the manner in which members should use rounding to calculate the transaction fees on self-reported trades; and (4) guidance regarding the appropriate terminology when referring to the transaction fees assessed by NASD under Section 3 of Schedule A to the NASD By-Laws. The relevant provisions of the Notice to Members are as follows:

⁸ NASD also is amending Section 3 of Schedule A to reflect that the applicable fee rate assessed by NASD is periodically adjusted in accordance with Section 31. In the past, NASD has notified members, through Member Alerts or other means, of any periodic adjustments to the fee rate made by the Commission. NASD will continue to notify members of any such adjustments in the future since NASD seeks to recover the costs of its Section 31 obligation from its members.

As adopted, the new procedures require NASD to tabulate aggregate sales volume based on information reported to its trade reporting systems and to submit this data to the SEC on SEC Form R31 on a monthly basis. Pursuant to SEC Rule 31(b)(1), NASD is required to submit to the SEC a completed Form R31 within ten business days after the end of each month. NASD currently has two trade reporting systems for purposes of Rule 31 under the Exchange Act – the Automated Confirmation Transaction Service (ACT) and the Trade Reporting and Confirmation Service (TRACS). In addition, NASD is required to compile and submit, through Form R31, similar trading activity information on trades that are not captured by ACT or TRACS.

Specifically, NASD is required to submit the aggregate dollar amount of covered sales that: (1) occurred by or through a member otherwise than on a national securities exchange; (2) had a “charge date”¹⁰ in the month of the report; and (3) NASD captured in its trade reporting systems. NASD also is required to submit trade data to the SEC on covered sales that are not captured on either ACT or TRACS, which would include covered sales in odd lots, covered sales resulting from the exercise of options settled by physical delivery and not listed or traded on a national securities exchange, and covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security (hereinafter referred to as away from the market sales).¹¹

Currently, NASD obtains trade data on covered sales in odd lots and covered sales resulting from the exercise of options settled by physical delivery and not listed or traded on a national securities exchange through a self-reporting mechanism, but trade data on away from the market sales is not captured in NASD’s trade reporting systems or through a self-reporting mechanism. Moreover, NASD previously had not included away from the market sales in its calculation of the transaction fees owed to the SEC under Section 31 based upon SEC guidance that such transactions were not subject to Section 31 fees.¹² In the Adopting Release, however, the SEC stated that it now believes that such transactions are subject to Section 31 fees where consideration is given for the securities. Therefore, as explained in greater detail below, NASD will begin seeking trade information on these transactions from members through self reporting so that it can satisfy its reporting obligation under the new SEC procedures.

SEC Rule 31T authorizes the SEC to collect trade data on all covered sales retroactively for each of the months September 2003 to June 2004, inclusive. Accordingly, the Rule as written requires NASD to submit trade data on away from the market sales for each of the months in the September 2003 to June 2004 period. Such an approach would require members to retroactively self report such transactions to NASD. NASD believes that requesting historical information from member firms on away from the market sales for the period from September 2003 to June 2004 is unduly burdensome on members. Therefore, NASD has sought an exemption from the SEC with respect to NASD’s retroactive reporting

obligation. Consequently, in light of NASD's pending exemption request, members will not have to review transactions between September 2003 and June 2004 to identify away from the market sales for that period.¹³ However, NASD will begin reporting away from the market sales effective July 2004 and for each month thereafter. To allow members more time to review their July 2004 transactions to identify away from the market sales for that month, NASD also has sought an exemption from the SEC so that NASD can report away from the market sales for July 2004 in the Form R31 that is due on September 15, 2004. The exemptions sought by NASD are intended to give member firms more time to make the necessary changes to their systems to facilitate the self reporting of away from the market sales.

* * *

Obligations of Member Firms

To recover the costs of NASD's Section 31 obligation, NASD assesses a transaction fee on its member firms under Section 3 of Schedule A to the NASD By-Laws, the amount of which is set in accordance with Section 31 of the Exchange Act.¹⁴ As noted above, the new SEC procedures relating to Section 31 do not directly affect the obligation of member firms to pay the transaction fees assessed by NASD. NASD anticipates that the impact of SEC's new procedures on its members will be minimal. NASD will continue to bill members for covered securities transactions that are reported through ACT on a monthly basis, as it does today. In addition, NASD will bill members for transactions reported through TRACS. Nonetheless, members should be aware that the new procedures adopted by the SEC will affect NASD practices and, pursuant to such practices, member's reporting obligations. Specifically, member firms now are required to self report away from the market sales¹⁵ – this is in addition to the currently self-reported covered sales in odd-lot transactions and covered sales resulting from the exercise of over-the-counter (OTC) options that settle by physical delivery.

In accordance with guidance provided in the SEC's Adopting Release, NASD has revised its existing self-reporting form so that members can report, in addition to odd-lot transactions and exercises of OTC options that settle by physical delivery, away from the market sales. In addition, NASD has created an Interim Self-Reporting Form to facilitate members' reporting of certain away from the market sales. NASD also will now require that trade data and applicable payments be received by NASD by the seventh calendar day of each month subsequent to the trade period covered on the report.¹⁶ Currently, members have until the tenth calendar day of each month to submit the trade data and payments to NASD. However, given the NASD's obligation to process the trade data in a shorter timeframe (NASD is required to submit the trade data to the SEC within ten business days after the end of each month), NASD is requiring members to provide the trade data and payments by the seventh calendar day of each month, beginning in September 2004.

Members must use the Interim Self-Reporting Form that is attached to this *Notice* to self report covered sales of odd-lots and OTC exercised options as well as away from the market sales for the August 2004 trade-reporting period. In addition, members must use the Interim Self-Reporting Form to report away from the market sales for the July 2004 trade-reporting period.¹⁷ The Interim Self-Reporting Form and applicable payments must be received by NASD by September 7, 2004. The Interim Self-Reporting Form will be used once only in September 2004.

To self report covered sales, including away from the market sales, for the September 2004 trade-reporting period and for each month thereafter, members must use the Permanent Self-Reporting Form, which also is attached to this *Notice*. The Permanent Self-Reporting Form becomes effective on October 1, 2004. The first Permanent Self-Reporting Form and applicable payments must be received by NASD by October 7, 2004. NASD reminds firms to print and retain blank copies of the Permanent Self-Reporting Form for future use.

NASD also reminds firms of their continuing obligation to ensure the accuracy and timeliness of information reported to NASD, including real-time trade information reported to ACT and TRACS and self-reported trade information. Moreover, because NASD will rely on self-reported data from member firms to complete Part III of SEC Form R31, it is imperative that firms submit accurate trade data to NASD on a timely basis on covered sales of odd-lot transactions and exercises of OTC options that settle by physical delivery, as well as away from the market sales.

Rounding and Disclosure of Transaction Fees

Currently, members calculate the transaction fees on self-reported trades by: (1) multiplying the aggregate dollar amount of self-reported covered sales by the fee rate; (2) truncating the resulting amount at the fifth place after the decimal point; and (3) rounding up to the next cent, if there is any remainder. While firms need not pass transaction fees on to their customer, it is NASD's understanding that such fees are frequently passed by broker-dealers on to their customers on a trade-by-trade basis.¹⁸ In addition, NASD understands that reconciling the amounts billed by NASD and the amounts collected by member firms has been difficult from a member firm perspective, resulting in overages at some broker-dealer firms, in part due to the practice of routinely rounding up to the next cent. To more accurately reconcile the amount that NASD bills its members and the amount collected by members from their customers, members should no longer solely round up when there is a remainder after truncating the resulting amount. Rather, if there is any remainder, members should alternate between rounding up and rounding down to the next cent.

With respect to the disclosure of the transaction fees that members pass on to their customers, the SEC does not believe that it is appropriate for members to refer to the fee assessed by NASD as “Section 31 Fees” or “SEC Fees.”¹⁹ Therefore, as noted by the SEC, members should refrain from labeling the fees as such to avoid any confusion by their customers.²⁰

¹⁰ The charge date for trades reported in Parts II and III of Form R31 is the trade date, with one exception. The charge date for covered sales resulting from the exercise of over-the-counter options that settle by physical delivery is the exercise date. In addition, NASD has sought an exemption from the SEC to permit the charge date for “as-of” trades reported by NASD in Form R31 to be the trade report date.

¹¹ See Securities Exchange Act Release No. 49928, 69 FR 41059, 41063.

¹² See Final Rule Regarding Securities Transactions Exempt From Transaction Fees, Securities Exchange Act Release No. 38073 (December 23, 1996), 61 FR 68590, 68592 n.27 (December 30, 1996).

¹³ In the event the SEC does not grant the requested exemption to NASD, NASD will require its members to report such information to it and will promptly inform its members of such fact and of the manner in which to report the information. At this time, however, NASD is proceeding under the assumption that such exemption will be granted.

¹⁴ Pursuant to the Investor and Capital Markets Fee Relief Act, the SEC is required to make periodic adjustments to the Section 31 fee rates. As noted above, the current fee rate is set at \$23.40 per million.

¹⁵ As stated in the Adopting Release, a gift of a security without consideration is not a “sale” for purpose of Sections 31(c) of the Exchange Act, and is not subject to Section 31 fees. Therefore, member firms are not required to self report transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security if no consideration is given for the securities.

¹⁶ If the seventh calendar day falls on a weekend or a public holiday, the report must be received by NASD on the first business day following the weekend or holiday.

¹⁷ The Interim Self-Reporting Form includes two tables for purposes of reporting away from the market sales for the July and August 2004 trade-reporting periods. Members must use the first table in the form to report away from the market sales for transactions occurring in August 2004. Members must use the second table in the form to report only away from the market sales and only for the month of July 2004.

¹⁸ See Letter from Ernest A. Pittarelli, Chairman, Securities Industry Association Operations Committee, to Jonathan G. Katz, Secretary, SEC, dated March 5, 2004.

¹⁹ Securities Exchange Act Release No. 49928, 69 FR 41059, 41072.

²⁰ NASD is filing a proposed rule change with the SEC to amend, among other things, the title of Section 3 of Schedule A to the NASD By-Laws from “SEC Transaction Fee” to “Regulatory Transaction Fee.”

Finally, NASD has revised its Permanent Self-Reporting Form so that going forward members can report covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security, with the exception of securities transactions where no consideration is given for the securities. NASD previously had not assessed a transaction fee on such sales because the Commission had stated that transactions

where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security were not subject to Section 31 fees.⁹ As stated in the Adopting Release, however, the Commission now believes that such securities sales are subject to Section 31 fees where consideration is given for the securities, and, therefore, such covered sales must be reported to the Commission.¹⁰ Accordingly, NASD is making conforming changes to the Permanent Self-Reporting Form, and it is filing the form with the Commission. The Permanent Self-Reporting Form will become effective on October 1, 2004, and members must use this form to report covered sales for the month of September 2004 and for each month thereafter. As discussed below, NASD is using a different self-reporting form for the collection of certain trade data.

NASD has created an Interim Self-Reporting Form to facilitate the collection of trade data and payments for covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security for the months of July and August 2004. The Interim Self-Reporting Form will be used once only in September 2004. Members must use the Interim Self-Reporting Form to report, for the month of August 2004, covered sales in odd-lot transactions, covered sales resulting from the exercise of over-the-counter options that

⁹ See Final Rule Regarding Securities Transactions Exempt From Transaction Fees, Securities Exchange Act Release No. 38073 (December 23, 1996), 61 FR 68590, 68592 n.27 (December 30, 1996).

¹⁰ Pursuant to SEC Rule 31T, as written, NASD is obligated to submit trade data on such covered sales for each of the months in the September 2003 to June 2004 period, but NASD has sought an exemption from the SEC with respect to NASD's retroactive reporting obligation. NASD has requested an exemption so that it would not be obligated to report such covered sales on a retroactive basis for the September 2003 to June 2004 period, and it would not be obligated to report to the SEC such covered sales for the month of July 2004 until the September 15, 2004 reporting date.

settle by physical delivery, and covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security. Members also must use the Interim Self-Reporting Form to report covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security for the month of July 2004. NASD must receive the Interim Self-Reporting Form, including any applicable payment, by September 7, 2004. NASD also is filing the Interim Self-Reporting Form with the Commission.

(2) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹¹ which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed changes to Section 3 of Schedule A to the NASD By-Laws and to the manner by which member firms refer to the fee assessed by NASD when passing it on to their customers is consistent with the protection of investors and the public interest in that it will avoid any confusion by members and their customers. In addition, the proposed rule change, including the portions of the Notice that are intended to assist members in complying with Section 3 of Schedule A to the NASD By-Laws, is consistent with Section 15A(b)(5) of the Act,¹² 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

¹¹ 15 U.S.C. 78o-3(b)(6).

¹² 15 U.S.C. 78o-3(b)(5).

any facility or system that NASD operates or controls.

(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.

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

The proposed rule change has been filed by NASD as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act¹³ and Rule 19b-4(f)(6) thereunder.¹⁴ Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days (or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest) after the date of this filing, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁵ and Rule 19b-4(f)(6) thereunder.¹⁶

¹³ 15 U.S.C. 78s(b)(3)(A).

¹⁴ 17 CFR 240.19b-4(f)(6).

¹⁵ 15 U.S.C. 78s(b)(3)(A).

¹⁶ 17 CFR 240.19b-4(f)(6).

Rule 19b-4(f)(6)(iii) under the Act¹⁷ requires the self-regulatory organization to provide the Commission written notice of its intent to file the proposed rule change at least five business days (or such shorter time as designated by the Commission) before doing so. NASD has requested that the Commission waive the five-day pre-filing notice requirement. The Commission has decided, consistent with the protection of investors and the public interest, to waive the five-day pre-filing requirement.

In addition, NASD has requested that the Commission waive the 30-day pre-operative waiting period, which would make the proposed rule operative immediately, so that NASD can satisfy its obligation under Section 31 of the Act on a timely basis.

The Commission finds that it is consistent with the protection of investors and the public interest to waive the 30-day pre-operative period in this case. For these reasons, the Commission waives the 30-day pre-operative period and designates that the proposal become operative immediately.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and

¹⁷ 17 CFR 240.19b-4(f)(6)(iii).

Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments also may be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-NASD-2004-129. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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.¹⁸

Margaret H. McFarland
Deputy Secretary

¹⁸ 17 CFR 200.30-3(a)(12).

NASD
Interim Self-Reporting Form for Odd-Lot,
OTC Exercised Option, and Away from the Market Sales
that are not Reported through ACT or TRACS

P.O. Box 7777-W4230
Philadelphia, PA 19175-4230

*****Effective September 1, 2004*****

*****Expires September 30, 2004*****

Important Note: This Interim Self-Reporting Form is to be used to report odd-lot, OTC exercised options, and away from the market sales for the August 2004 trade-reporting period. In addition, this Interim Self-Reporting Form is to be used to report away from the market sales for the July 2004 trade-reporting period.

Only NASD members that are clearing firms (including self-clearing firms) should be submitting this form to NASD. All clearing firms are expected to collect any applicable trading information from their respective correspondent firms to be included in the aggregate totals. The trade date must be used when determining aggregate odd-lot and away from the market sales transactions for the preceding calendar month. The exercise date must be used when reporting aggregate OTC exercised option sales for the preceding calendar month.

General Instructions

The purpose of this form is to facilitate the collection of transaction fees under Section 3 of Schedule A to the NASD By-Laws with respect to transactions in odd-lots, transactions effected pursuant to the exercise of OTC options, and certain transactions that occur away from the market.

Please retain a copy of this blank form for your firm's monthly reporting. Additional copies of this form may be obtained by contacting the NASD Finance Department at (240) 386-5354.

If your firm does not process odd-lot transactions or if all odd-lot trades are submitted to the Automated Confirmation Transaction Service (ACT) or Trade Reporting and Comparison Service (TRACS) for trade reporting purposes, please submit the form with an "N/A" for the aggregate sales amount.

If your firm does not process any of the types of transactions identified on this form, please submit the blank form signed by an authorized representative, along with a letter of explanation detailing the reason your firm does not process any of the identified transactions. Future filings of this blank form for inactivity will not be necessary. If applicable transactions are processed in the future, your firm will be expected to file this form along with payment in a timely manner.

Odd-Lot Transactions

NASD members that are clearing firms, including self-clearing firms, must report aggregate dollar amount of covered odd-lot sales transacted by or through such member, including all such sales by the member's correspondent firm(s). Firms must report odd-lot sales under the same general rules and guidelines applicable to round lot transactions as detailed in Special Notice to Members 96-81 dated December 3, 1996 and the SEC Billing Document from NASD in December 1996. Member firms should consider the following when accumulating odd-lot data for each reporting period:

- Odd-lot transactions are those sides for less than the normal trading unit, e.g., 100 shares. Do not include "mixed lots" as part of your odd-lot reporting.
- Include all transactions where you or your correspondent firms represent the sell side of the odd-lot transaction.
- Include all transactions where you or your correspondent firms represent the buy side of a transaction with or between public customers or non-NASD member firms.
- Include all odd-lot transactions in Nasdaq securities, excluding convertible debt listed on Nasdaq.
- Include all odd-lot transactions in all non-Nasdaq OTC Equity Securities as defined in NASD Rule 6610.
- Include all odd-lot transactions in all non-Nasdaq OTC Equity Securities that are ADRs or Canadian foreign securities but exclude all non-Nasdaq non-Canadian foreign securities. Consolidate all odd-lot transactions with that of your correspondents, if any.
- Do include, in this form, odd-lot transactions in exchange registered securities traded off the exchange ("third market trades").
- **Do not include odd-lot transactions that are trade reported to either ACT or TRACS. This form must only be used for odd lots that are not trade reported to ACT or TRACS.**

OTC Options Exercise

Use this section of the form to report all transactions in a covered security effected pursuant to the exercise of an OTC option by or through a member that is a clearing firm (including self-clearing firm) or its correspondent firm(s). Covered securities are those securities that are subject to prompt last-sale-reporting and exchange-registered securities. Member firms should determine the following when accumulating options exercise data for each calendar reporting period:

- This form is only used to report transactions in covered securities that arise pursuant to the exercise of an OTC option by or through an NASD member that settle by physical delivery.
- Include all transactions where you or your correspondent firms represent the sell side of the transaction.
- Include all transactions where you or your correspondent firms represent the buy side of a transaction with or between public customers or non-NASD member firms.
- Do not include any transactions in a covered security effected pursuant to the exercise of an exchange-registered option, e.g., a purchase or sale of a Nasdaq or OTC Equity Security upon the exercise of an exchange-registered option. The Options Clearing Corporation will be collecting the fee for these types of transactions.
- Do not include any exercise of an option not involving the purchase or sale of the underlying covered security, e.g., a cash settled exercise.
- Report the aggregate dollar amount of the transactions determined on the basis of the exercise price.

Sales Away From The Market That Are Not Required To Be Reported By NASD Rules

NASD members that are clearing firms (including self-clearing firms) must report aggregate dollar amount of covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security and where these sales were not required to be reported pursuant to NASD Rules. Firms should not report trade data that already has been reported to ACT or TRACS. In addition, members are not required to include transactions involving a gift of a security **without** consideration because such a transaction is not considered a “sale” for purposes of this form.

This self-reporting form includes two tables for purposes of reporting sales away from the market for the July and August trade-reporting periods. Members must use the first table in the form to report sales away from the market (in addition to odd lots and OTC exercised options) as part of their regular reporting obligation for transactions occurring in August 2004. Members must use the second table in the form to report only sales away from the market and only for the month of July 2004. Please use this interim form only for the July and August 2004 trade-reporting periods and use the Permanent Self-Reporting Form (effective October 1, 2004) to report covered sales for the September 2004 trade-reporting period and going forward.

**NASD Interim Self-Reporting Form
Odd-Lot, OTC Exercised Options, and Away from the Market Sales**

*****Effective September 1, 2004*****

Transaction Fees under Section 3 of Schedule A to the NASD By-Laws for the Calendar Month of August 2004 for odd-lot, OTC exercised option, and away from the market sales.

Report of Sales by: **Firm Name** _____
 B/D# _____
 Clearing# _____

<i>Transaction</i>	<i>Aggregate Sales/Exercise Price</i>	<i>Rate</i>	<i>Fee Due</i>
Odd-Lot Transactions	\$	0.0000234	\$
Exercised Options	\$	0.0000234	\$
Sales Away From the Market	\$	0.0000234	\$

Total Amount Due \$ _____

Transaction Fees under Section 3 of Schedule A to the NASD By-Laws for the Calendar Month of July 2004 for away from the market sales.

Report of Sales by: **Firm Name** _____
 B/D# _____
 Clearing# _____

<i>Transaction</i>	<i>Aggregate Sales/Exercise Price</i>	<i>Rate</i>	<i>Fee Due</i>
Sales Away From the Market (covering July 2004)	\$	0.0000234	\$

Total Amount Due \$ _____

*****IMPORTANT*** PAYMENT FOR TOTAL AMOUNT DUE MUST BE
SUBMITTED WITH THIS REPORT.**

NASD must receive this Form and Payment by September 7, 2004. Please submit this form and payment to:

**NASD
P.O. Box 7777-W4230
Philadelphia, PA 19175-4230**

Signature of Authorized Representative

Title

Print Name

_____/_____
Date/Telephone Number

Address (Street, City, State, Zip)

E-mail Address

NASD
Permanent Self-Reporting Form for Odd-Lot,
OTC Exercised Option, and Away from the Market Sales
that are not Reported through ACT or TRACS

P.O. Box 7777-W4230
Philadelphia, PA 19175-4230

*****Effective October 1, 2004*****

Important Note: Only NASD members that are clearing firms (including self-clearing firms) should be submitting this form on a monthly basis to NASD. All clearing firms are expected to collect any applicable trading information from their respective correspondent firms to be included in the aggregate totals. The trade date must be used when determining aggregate odd-lot and away from the market sales transactions for the preceding calendar month. The exercise date must be used when reporting aggregate OTC exercised option sales for the preceding calendar month.

General Instructions

The purpose of this form is to facilitate the collection of transaction fees under Section 3 of Schedule A to the NASD By-Laws with respect to transactions in odd-lots, transactions effected pursuant to the exercise of OTC options, and certain transactions that occur away from the market.

Please retain a copy of this blank form for your firm's monthly reporting. Additional copies of this form may be obtained by contacting the NASD Finance Department at (240) 386-5354.

If your firm does not process odd-lot transactions or if all odd-lot trades are submitted to the Automated Confirmation Transaction Service (ACT) or Trade Reporting and Comparison Service (TRACS) for trade reporting purposes, please submit the form with an "N/A" for the aggregate sales amount.

If your firm does not process any of the types of transactions identified on this form, please submit the blank form signed by an authorized representative, along with a letter of explanation detailing the reason your firm does not process any of the identified transactions. Future filings of this blank form for inactivity will not be necessary. If applicable transactions are processed in the future, your firm will be expected to file this form along with payment in a timely manner.

Odd-Lot Transactions

NASD members that are clearing firms, including self-clearing firms, must report aggregate dollar amount of covered odd-lot sales transacted by or through such member, including all such sales by the member's correspondent firm(s). Firms must report odd-lot sales under the same general rules and guidelines applicable to round lot transactions as detailed in Special Notice to Members 96-81 dated December 3, 1996 and the SEC Billing Document from NASD in December 1996. Member firms should consider the following when accumulating odd-lot data for each reporting period:

- Odd-lot transactions are those sides for less than the normal trading unit, e.g., 100 shares. Do not include "mixed lots" as part of your odd-lot reporting.
- Include all transactions where you or your correspondent firms represent the sell side of the odd-lot transaction.
- Include all transactions where you or your correspondent firms represent the buy side of a transaction with or between public customers or non-NASD member firms.
- Include all odd-lot transactions in Nasdaq securities, excluding convertible debt listed on Nasdaq.
- Include all odd-lot transactions in all non-Nasdaq OTC Equity Securities as defined in NASD Rule 6610.
- Include all odd-lot transactions in all non-Nasdaq OTC Equity Securities that are ADRs or Canadian foreign securities but exclude all non-Nasdaq non-Canadian foreign securities. Consolidate all odd-lot transactions with that of your correspondents, if any.
- Do include, in this form, odd-lot transactions in exchange registered securities traded off the exchange ("third market trades").
- **Do not include odd-lot transactions that are trade reported to either ACT or TRACS. This form must only be used for odd lots that are not trade reported to ACT or TRACS.**

OTC Options Exercise

Use this section of the form to report all transactions in a covered security effected pursuant to the exercise of an OTC option by or through a member that is a clearing firm (including self-clearing firm) or its correspondent firm(s). Covered securities are those securities that are subject to prompt last-sale-reporting and exchange-registered securities. Member firms should determine the following when accumulating options exercise data for each calendar reporting period:

- This form is only used to report transactions in covered securities that arise pursuant to the exercise of an OTC option by or through an NASD member that settle by physical delivery.
- Include all transactions where you or your correspondent firms represent the sell side of the transaction.
- Include all transactions where you or your correspondent firms represent the buy side of a transaction with or between public customers or non-NASD member firms.

- Do not include any transactions in a covered security effected pursuant to the exercise of an exchange-registered option, e.g., a purchase or sale of a Nasdaq or OTC Equity Security upon the exercise of an exchange-registered option. The Options Clearing Corporation will be collecting the fee for these types of transactions.
- Do not include any exercise of an option not involving the purchase or sale of the underlying covered security, e.g., a cash settled exercise.
- Report the aggregate dollar amount of the transactions determined on the basis of the exercise price.

Sales Away From The Market That Are Not Required To Be Reported By NASD Rules

NASD members that are clearing firms (including self-clearing firms) must report aggregate dollar amount of covered sales where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security and where these sales were not required to be reported pursuant to NASD Rules. Firms should not report trade data that already has been reported to ACT or TRACS. In addition, members are not required to include transactions involving a gift of a security **without** consideration because such a transaction is not considered a “sale” for purposes of this form.

Transaction Fees under Section 3 of Schedule A to the NASD By-Laws for the Calendar Month of _____, 200() for odd-lot, OTC exercised option, and away from the market sales.

Clearing#

Total Amount Due \$ _____

*****IMPORTANT*** PAYMENT FOR TOTAL AMOUNT DUE MUST BE SUBMITTED WITH THIS REPORT.**

NASD must receive this Form and Payment by the 7th calendar day¹⁹ subsequent to the subject trade-reporting period. Please submit this form and payment to:

**NASD
P.O. Box 7777-W4230
Philadelphia, PA 19175-4230**

Signature of Authorized Representative

Title

Print Name

_____/_____
Date/Telephone Number

Address (Street, City, State, Zip)

E-mail Address

¹⁹ If the 7th calendar day falls on a weekend or a public holiday, the report must be received by NASD on the first business day following the weekend or public holiday.