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For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47946; File No. SR-NASD-2002-148]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1 and 2, and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3 and 4 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., to Eliminate the Regulatory Fee and Institute a Transaction-Based Trading Activity Fee

May 30, 2003.

#### I. Introduction

On October 18, 2002, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to eliminate the NASD's Regulatory Fee and institute a new, transaction-based Trading Activity Fee ("TAF"). The NASD amended the proposed rule change on November 5, 2002,<sup>3</sup> and November 8, 2002.<sup>4</sup> The proposed rule change, as modified by Amendment Nos. 1 and 2, was published for notice

and comment in the **Federal Register** on November 19, 2002.<sup>5</sup> The Commission received 23 comments<sup>6</sup> on the proposal.<sup>7</sup> On March 18, 2003, the

<sup>5</sup> See Securities Exchange Act Release No. 46817 (November 12, 2002), 67 FR 69784.

<sup>6</sup> There are 15 comment letters submitted for the instant proposed rule change. However, the Commission also is considering comment letters submitted for SR-NASD-2002-98, SR-NASD-2002-147, SR-NASD-2003-26 and SR-NASD-2003-73. See footnotes 7 and 9, *infra*.

<sup>7</sup> The NASD eliminated the Regulatory Fee and instituted the TAF when it filed SR-NASD-2002-98. See Securities Exchange Act Release No. 46416 (August 23, 2002), 67 FR 55901 (August 30, 2002). The proposal was effective upon filing with the Commission, pursuant to section 19(b)(3)(A)(ii) of the Act, and Rule 19b-4(f)(2) thereunder. 15 U.S.C. 78s(b)(3)(A)(ii), 17 CFR 240.19b-4(f)(2). The Commission received 10 comments on SR-NASD-2002-98. See September 17, 2002 letter from Lanny A. Schwartz, Philadelphia Stock Exchange, Inc. ("Phlx"), to Jonathan G. Katz, Secretary, SEC ("Phlx Letter"); September 18, 2002 letter from Edward J. Joyce, President and Chief Operating Officer, The Chicago Board Options Exchange, Inc. ("CBOE"), to Jonathan G. Katz, Secretary, SEC ("CBOE Letter #1"); September 20, 2002 letter submitted jointly by The American Stock Exchange LLC ("Amex"), CBOE, the International Securities Exchange, Inc. ("ISE"), The Options Clearing Corporation ("OCC"), The Pacific Exchange, Inc. ("PCX"), and the Phlx, to Jonathan G. Katz, Secretary, SEC ("OCC Joint Letter #1") (OCC Joint Letter #1 was later withdrawn.); September 23, 2002 letter from Susan Milligan, First Vice President and Special Counsel, OCC, to Jonathan G. Katz, Secretary, SEC ("OCC Joint Letter #2") (withdraws OCC Joint Letter #1 and substitutes a new letter that is identical to OCC Joint Letter #1 except for the removal of the Amex as a signatory to the letter); September 27, 2002 letter from Jeffrey T. Brown, Senior Vice President ("SVP"), Secretary and General Counsel ("GC"), The Cincinnati Stock Exchange, Inc. ("CSE"), to Jonathan G. Katz, Secretary, SEC ("CSE Letter #1"); September 26, 2002 letter from Stuart J. Kaswell, Senior Vice President ("SVP") and GC, The Securities Industry Association ("SIA"), to Jonathan G. Katz, Secretary, SEC ("SIA Letter #1"); October 21, 2002 letter from Margaret Wiermanski, Chief Compliance Officer, TD Securities, to Jonathan G. Katz, Secretary, SEC ("TD Securities Letter"); March 13, 2003 letter from John Boese, VP, Legal and compliance, The Boston Stock Exchange ("BSE"), to Jonathan G. Katz, Secretary, SEC ("BSE Letter"); March 27, 2003 letter from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Jonathan G. Katz, Secretary, SEC ("CBOE Letter #3"); May 15, 2003 letter from Margaret Wiermanski, VP-Compliance, TD Options, LLC, to Jonathan G. Katz, Secretary, SEC ("TD Options Letter").

The NASD also filed SR-NASD-2002-147, which transformed the TAF into a pilot program, scheduled to terminate on December 31, 2002. See Securities Exchange Act Release No. 46818 (November 12, 2002), 67 FR 69782 (November 19, 2002). The Commission received eight comments on SR-NASD-2002-147, which were submitted as joint letters for SR-NASD-2002-147 and SR-NASD-2002-148. Letters for SR-NASD-2002-147 are not listed separately in this order, because they are fully documented in the list of comment letters for SR-NASD-2002-148.

Subsequently, the NASD filed the instant proposed rule change (SR-NASD-2002-148), which contained substantially the same proposed rule language as was contained in SR-NASD-2002-98, but was submitted pursuant to Section 19(b)(2) of the Act to allow for an additional notice and comment period per the commenters' requests. See Securities Exchange Act Release No. 46817 (November 12, 2002), 67 FR 69785 (November 19,

NASD responded to the comments, and amended the proposed rule change again.<sup>8</sup> On April 14, 2003, the NASD extended the pilot program through June 1, 2003.<sup>9</sup> On May 19, 2003, the NASD amended the proposed rule change a fourth time.<sup>10</sup> This order

2002). The Commission received 15 comments on SR-NASD-2002-148. See December 6, 2002 letter from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Jonathan G. Katz, Secretary, SEC ("CBOE Letter #2"); December 6, 2002 letter from William C. McGowan, Managing Director, TD Professional Execution, Inc., to Jonathan G. Katz, Secretary, SEC ("TD ProEx Letter"); December 10, 2002 letter from Eric Noll, Susquehanna International Group, LLP, to Jonathan G. Katz, Secretary, SEC ("Susquehanna Letter"); December 10, 2002 letter from Jeffrey T. Brown, SVP, Secretary and GC, CSE, to Jonathan G. Katz, Secretary, SEC ("CSE Letter #2"); December 9, 2002 letter from Barry S. Augenbraun, SVP and Corporate Secretary, Raymond James Financial, Inc., to Jonathan G. Katz, Secretary, SEC ("Raymond James Letter"); December 9, 2002 letter from Stuart J. Kaswell, SVP and GC, SIA, to Jonathan G. Katz, Secretary, SEC ("SIA Letter #2"); January 23, 2003 letter from Mary McDermott-Holland, Vice Chairman, Chair, Trading Issues Committee, to Jonathan G. Katz, Secretary, SEC ("STA Letter"); December 11, 2002 letter from Darla C. Stuckey, Corporate Secretary, The New York Stock Exchange, Inc. ("NYSE"), to Jonathan G. Katz, Secretary, SEC ("NYSE Letter #1"); December 5, 2002 letter, submitted jointly by CBOE, OCC, ISE, PCX, and Phlx, to Jonathan G. Katz, Secretary, SEC ("OCC Joint Letter #3"); BSE Letter; CBOE Letter #3; March 24, 2003 letter submitted jointly by CBOE, OCC, ISE, PCX, and Phlx, to Jonathan G. Katz, Secretary, SEC ("OCC Joint Letter #4"); TD Options Letter; April 10, 2003 letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Jonathan G. Katz, Secretary, SEC ("NYSE Letter #2"); May 27, 2003 letter from Gabriel A. Duran, Chief Compliance Officer, GVR Company, LLC, to Jonathan G. Katz, Secretary, SEC ("GVR Letter").

The NASD extended the pilot in SR-NASD-2002-182, through March 1, 2003. The Commission received no comments on SR-NASD-2002-182. The NASD extended the pilot through April 1, 2003 in SR-NASD-2003-26. See Securities Exchange Act Release No. 47436 (March 4, 2003), 68 FR 11422 (March 10, 2003). The Commission received two comments on SR-NASD-2003-26. NYSE Letter #2; GVR Letter.

<sup>8</sup> See March 18, 2003 letter from Barbara Z. Sweeney, SVP and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, SEC, ("NASD Response Letter" or "Amendment No. 3"). In Amendment No. 3, the NASD (1) responded to the comments; (2) incorporated the interpretations contained in *Notices to Members 02-36* and *02-75* in the proposed rule language. See also, March 28, 2003 letter from Kathleen A. O'Mara, Associate General Counsel, Regulatory Policy and Oversight, NASD, to Katherine A. England, Assistant Director, and Joseph Morra, Special Counsel, Division of Market Regulation, SEC (via email) ("NASD Response Letter #2").

<sup>9</sup> See Securities Exchange Act Release No. 47685 (April 16, 2003), 68 FR 20198 (April 24, 2003) (SR-NASD-2003-73). The Commission received two comments on the proposed rule change. See May 13, 2003 letter from Robert Bellick, Christopher Gust, Wolverine Trading, LLC, to Jonathan G. Katz, Secretary, SEC ("Wolverine Letter"); GVR Letter.

<sup>10</sup> See May 19, 2003 letter from Barbara Z. Sweeney, SVP and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, SEC ("Amendment No. 4"). In Amendment No. 4, the NASD proposes to exempt from the TAF listed

Continued

<sup>8</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See November 4, 2002 letter from Barbara Z. Sweeney, Senior Vice President ("SVP") and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), SEC, and attachments ("Amendment No. 1"). Amendment No. 1 completely replaced and superseded the original proposed rule change.

<sup>4</sup> See November 7, 2002 letter from Barbara Z. Sweeney, SVP and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, SEC, and attachments ("Amendment No. 2"). Amendment No. 2 completely replaced and superseded Amendment No. 1 and the original proposed rule change.

approves the proposed rule change as modified by Amendment Nos. 1 and 2. Simultaneously, the Commission provides notice of filing of Amendment Nos. 3 and 4, and grants accelerated approval of Amendment Nos. 3 and 4.

## II. Summary of Comments

The Commission received a total of 23 comment letters on the NASD's proposal to eliminate the Regulatory Fee and institute the TAF,<sup>11</sup> all of which objected to the proposal, either for substantive or procedural reasons.<sup>12</sup> The following summary of comments provides an overview of the commenters' concerns.

- *The NASD Should Not Charge Its Members for Services Related to Transactions on Other Markets, Where the NASD Does Not Provide the Relevant Service*

A number of commenters stated it is improper for the NASD to collect a fee from its members relating to transactions on other markets, because in that case, other markets, not the NASD, provide the relevant services.<sup>13</sup> For example, one commenter objected to the NASD's proposal to apply the TAF to transactions for options market makers who are non-NASD members who effect a transaction on an away exchange, emphasizing that the NASD and the options exchanges share options sales practice responsibilities, and that the NASD's responsibilities "are likely to decrease, not increase in the near future."<sup>14</sup> Expanding on that theme,

options transactions for members for which the NASD is not the designated options examining authority. The NASD proposes to make this amendment effective on January 1, 2004.

<sup>11</sup> See footnotes 6, 7 and 9, *supra*.

<sup>12</sup> Some commenters expressed their disapproval that the NASD filed the initial TAF proposal for immediate effectiveness. See, e.g., Raymond James Letter. The Commission notes, however, that the point is moot, since the NASD subsequently filed SR-NASD-2002-147 and SR-NASD-2002-148, thereby allowing for full notice and comment on the proposal. Additionally, some commenters objected to the TAF being effective upon filing with the Commission because they believe the lack of notice and comment was unreasonable, and that it imposed hardship on member firms that were required to make extensive programming changes with insufficient notice. SIA Letter #1; Raymond James Letter at 1-2; SIA Letter #2 at 2, 5, 7.

<sup>13</sup> Phlx Letter at 1; CSE Letter #1 at 4-5 ("To go outside its own jurisdiction to recoup regulatory expenses without justification inappropriately places the burden for the operation and regulation of the [NASD] on other exchanges."); TD Securities Letter (TD Securities Letter concurs completely with CSE Letter #1); SIA Letter #1 at 3; CBOE Letter #2 at 2; Susquehanna Letter at 1-3; CSE Letter #2 at 1-2; STA Letter at 2; NYSE Letter #1 at 2 ("\* \* \* NASD is not empowered to act as the primary regulator across markets and over activities unique to other SROs. Consequently, no basis exists for it to impose such fees.")

<sup>14</sup> CBOE Letter #2 at 2.

another commenter suggested that the NASD provide more specific information about the costs to be borne by the NASD, and the relationship of those costs to the fees the NASD intends to charge, as well as the precise regulatory services the NASD performs and the NASD's authority to impose fees "for services not unique to it."<sup>15</sup>

- *The TAF Proposal Is Anti-Competitive Because It Indirectly Subsidizes Nasdaq by Effectively Reducing the Cost of Regulatory Services the NASD Provides to Nasdaq*

Some commenters objected to the proposed rule change on the basis that, by charging NASD members for securities transactions regardless of where a trade is executed, the NASD is providing an indirect subsidization to Nasdaq by reducing the cost to Nasdaq of regulatory services that the NASD provides to Nasdaq.<sup>16</sup> They claimed that the TAF proposal is the NASD's and Nasdaq's attempt to ensure that the revenue stream generated by trading in Nasdaq securities remains available, asserting that the NASD is subjecting transactions on competing markets to the TAF in an effort to subsidize Nasdaq's regulatory burden.<sup>17</sup>

- *Applying the TAF to Listed Options Transactions That Are Cleared by NASD Members Is Inappropriate*

Several commenters said that applying the TAF to listed options transactions that are cleared by NASD members is inappropriate because the NASD's regulatory responsibility for the listed options market is minimal.<sup>18</sup> Making a similar point, but from the opposite perspective, a number of commenters said the TAF is inequitable because the NASD will not apply the TAF to many over-the-counter instruments, such as debt and variable annuities, where the NASD has primary regulatory responsibility.<sup>19</sup>

<sup>15</sup> NYSE Letter #1 at 2.

<sup>16</sup> Phlx Letter at 2; CSE Letter #1 at 8-9; CSE Letter #2 at 3.

<sup>17</sup> See, e.g., CSE Letter #1 at 3-4; NYSE Letter #1 at 1 ("\* \* \* NASD plans to capture new revenue sources so as to supplant and supplement fees lost when Nasdaq securities began to trade on markets other than the Nasdaq. Thus, the NASD proposes to impose regulation-related costs to fill a shortfall caused by competitively induced market share loss. This approach clearly is anti-competitive."); BSE Letter at 2 ("\* \* \* they are attempting to regain market share through anti-competitive rules \* \* \*").

<sup>18</sup> CBOE Letter #1 at 1-2; CBOE Letter #2 at 2; TD ProEx Letter at 1; Susquehanna Letter at 2; STA Letter at 2; BSE Letter at 4.

<sup>19</sup> CBOE Letter #1 at 2; OCC Joint Letter #2 at 1-2; CBOE Letter #2 at 2; TD ProEx Letter at 1; STA Letter at 3; OCC Joint Letter #3 at 3-4.

- *The TAF Proposal Sets a Dangerous Precedent; a Single Transaction Could Incur Multiple Charges, Regardless of Regulatory Responsibilities or Nexus of Business Interest*

Some commenters expressed concern about the precedent the TAF proposal would set, where other self-regulatory organizations ("SROs") might impose fees on transactions executed on markets for which the SRO performs no regulatory tasks, or for which the SRO has no business interest.<sup>20</sup> However, one commenter acknowledged, "assessing a fee on trading activity occurring in other markets may be justified given the NASD's responsibility for member regulation \* \* \*" (Emphasis in original).<sup>21</sup> The commenter suggested that this concept is unprecedented, and that the impact should be examined carefully, given the concern that other self-regulatory organizations may impose similar fees, resulting in firms possibly paying considerably more than what is fair for regulation.<sup>22</sup>

- *The Interpretations in Notices to Members 02-75 and 02-63 Should Be Included in the Proposed Rule Language*

Notice to Members 02-75 states the TAF is not imposed on transactions for non-member broker-dealers who clear through an NASD member, unless the NASD clearing member firm also acts as executing broker in the transaction. Also, Notice to Members 02-63 states that transactions effected on a national securities exchange by a dually registered specialist or floor based market maker will not be subject to the TAF. Several commenters suggested that this language be included in the proposed rule language, to ensure that the language is not removed from the rule without the filing of a proposed rule change.<sup>23</sup>

<sup>20</sup> See, e.g., CBOE Letter #1 at 2; OCC Joint Letter #2 at 2 ("NASD should not be permitted to generate revenue and raise the costs of trading on the options exchanges without a showing that the amount of the TAF is limited to the recovery of its costs in connection with regulating listed options."); CBOE Letter #2 at 3; TD ProEx Letter at 2-3; STA Letter at 2; OCC Joint Letter #3 at 4; BSE Letter at 2, 4.

<sup>21</sup> SIA Letter #2 at 6.

<sup>22</sup> *Id.* ("Given this significant expansion of the scope of the fee, and the possible precedential effect it may have in the industry, we believe that the NASD should be required to provide in more detail a fair and reasonable basis for expanding the scope of the TAF to cover transactions executed in any market.")

<sup>23</sup> CBOE Letter #2 at 2 and Susquehanna Letter at 2 (regarding Notice to Members 02-75); TD ProEx Letter at 3 (regarding Notice to Members 02-63); OCC Joint Letter #3 at 6 (regarding both Notices to Members).

• *The NASD Could Raise the Fee at Any Time*

Some commenters expressed concern that the NASD could raise the fee at any time, within its own discretion without notice and comment and Commission approval.<sup>24</sup>

• *The Proposed Rule Language is Vague and Discretionary*

One commenter stated that the proposed rule language was ambiguous, and that such vagueness would allow the NASD to “arbitrarily apply the fees to certain members while exempting others.”<sup>25</sup> The same commenter said that the proposed rule language that allows the NASD to exempt other securities and transactions as it deems appropriate would provide the NASD with discretion to create exemptions without having to present the exemptions to the Commission for approval.<sup>26</sup>

### III. The NASD's Response to Comments

The NASD responded to the comments,<sup>27</sup> discussing its rationale for the structure of its TAF proposal, and modifying the proposal to accommodate some of the commenters' concerns. The NASD's responses to the more significant issues are addressed below.

The NASD clarified that the TAF is to be used only to fund its member regulatory activities in a variety of areas such as “sales practices, routine examinations, financial and operational reviews, new member applications, enforcement \* \* \*” wherever such member activity occurs.<sup>28</sup> Although the NASD will regulate activities of its members in all securities, including Nasdaq securities, the NASD states that revenues from the TAF will not fund regulatory activities of the Nasdaq stock market, and also states that Nasdaq will not receive any subsidy based on the TAF.<sup>29</sup>

Regarding suggestions that the TAF proposal is unfair or inequitable, the NASD stated that it chose to model the TAF after the SEC's Section 31 fee to simplify its framework for recouping its regulatory costs, and, in part, to minimize the programming impact on firms.<sup>30</sup> Debt, mutual funds, and

variable annuities were excluded from the TAF, in keeping with this model, and the NASD set its Personnel Assessment and Gross Income Assessment rates at a level designed to ensure that regulatory expense levels for such products were funded fairly and adequately.<sup>31</sup> The NASD asserted that listed options are properly assessed under the TAF, since the NASD maintains regulatory responsibility for its members for options, and the “NASD continues to assume the largest share of options self-regulatory allocation through the Options Self-Regulatory Council.”<sup>32</sup> Furthermore, the NASD stated that its current costs for options regulation exceed the revenue the NASD anticipates receiving from this portion of the TAF.<sup>33</sup>

In response to the commenters' concern that the TAF proposal does not contain the exemptions to the TAF provided in *Notices to Members 02-63* and *02-75*, the NASD amended the proposed rule change to accommodate the commenters' request.<sup>34</sup>

With regard to comments that suggest that the NASD has not established a clear nexus between the TAF and the corresponding NASD regulatory responsibilities, the NASD maintained that its mandate is broad, and that its regulatory obligations “exist separate and apart from any market-specific rules and obligations.”<sup>35</sup> Additionally, the NASD filed Amendment No. 4, which creates an exemption from the TAF for listed options transactions for members for which the NASD is not the designated options examining authority.

### IV. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change, the comment letters, and the NASD's response to the comments, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations

thereunder applicable to a national securities association<sup>36</sup> and, in particular, the requirements of section 15A(b)(5) of the Act.<sup>37</sup> Section 15A(b)(5) requires, among other things, that the rules of a national securities association 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 the association operates or controls. The Commission finds that the elimination of the Regulatory Fee, and the implementation of the TAF, as described in the instant proposed rule change, is consistent with section 15A(b)(5) of the Act, in that the proposal is reasonably designed to recover NASD costs related to regulation and oversight of its members.

The Commission recognizes the difficulties inherent in restructuring the NASD's regulatory fees, and believes that the NASD has done so in a manner that is fair and reasonable. The Commission believes that the NASD's proposed TAF, in conjunction with the Gross Income Assessment, is reasonably tailored to apportion fees based on the regulatory services the NASD provides.

With respect to the commenters' assertion that the NASD should not charge its members with respect to transactions on other markets, a conclusive factor in the Commission's approval of the rule is the NASD's broad responsibilities with respect to its members' activities, irrespective of where securities transactions take place. As a national securities association, the NASD has the responsibility to oversee its members' finances and conduct toward their customers, except in limited circumstances where this responsibility is allocated to another SRO. The NASD's responsibility exists even if the conduct involves a transaction executed on a market not directly regulated by the NASD. With respect to its members doing business with the public, the NASD incurs costs to regulate its members through financial responsibility reviews, examinations, and other compliance monitoring.

The NASD's proposal uses volume of transactions as a means of allocating regulatory costs to its members, in addition to gross income and personnel fees. Assessing fees in relation to transactions correlates to heightened NASD responsibilities regarding firms that engage in the trading. In most cases,

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 5.

<sup>33</sup> *Id.*

<sup>34</sup> In response to some commenters' assertion that the NASD should codify the exemption discussed in *Notice to Members 02-75* for non-member broker-dealers that clear through an NASD member broker-dealer, unless the NASD member executes the transaction, the NASD stated that the NASD does not assess a fee on a non-NASD member for its role in effecting a transaction, regardless of where the transaction is cleared; however, if an NASD member clearing firm acts as executing broker for a non-NASD member broker-dealer correspondent, the NASD will assess a fee to the NASD clearing member. The NASD does not believe this qualifies as an exemption to the TAF, and therefore, does not think it should be included in the rule.

<sup>35</sup> *Id.* at 5-6.

<sup>36</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>37</sup> 15 U.S.C. 78o-3(b)(5).

<sup>24</sup> CBOE Letter #2 at 3 (“Even though the current level of the TAF options fee is relatively small, the NASD could raise the fee at any time. Once the NASD establishes the precedent that it can tax options trades, there will be little check on its ability to raise the fee substantially.”); Susquehanna Letter at 3.

<sup>25</sup> CSE Letter #2 at 3.

<sup>26</sup> *Id.*

<sup>27</sup> See footnote 8, *supra*.

<sup>28</sup> NASD Response Letter #1 at 3-4.

<sup>29</sup> *Id.* at 4.

<sup>30</sup> *Id.*

the NASD has direct responsibility to oversee the firm's dealing with the public in effecting the transactions; the NASD may also have responsibility to oversee the impact of the trading on the firm's financial condition. In most cases, where responsibility for certain member activities has been allocated to other SROs, the NASD retains responsibility for other member functions. Thus, while trading activity is not wholly correlated to the full range of NASD responsibility for members in all instances, the Commission believes that they are closely enough connected to satisfy the statutory standard. To more narrowly tailor the transaction fees to regulatory duties, the NASD filed Amendment No. 4 to create an exemption from the TAF for listed options transactions of members for which the NASD is not the designated options examining authority. The Commission is granting accelerated approval of Amendment Nos. 3 and 4 to ensure that these changes are made simultaneously with the approval of the TAF proposal.<sup>38</sup> The Commission is satisfied that the NASD has made a good faith effort to exclude those types of transactions where there does not exist a substantial nexus to the NASD's regulatory responsibilities.

The Commission does not believe that approval of the NASD's TAF proposal opens the door to the imposition of fees on transactions executed on markets for which an SRO either has little or no nexus to regulatory tasks performed by the SRO or for which the SRO has no business interest. In setting their fees, the SROs must meet the statutory standard established in sections 6(b)(5)<sup>39</sup> and 15A(b)(5) of the Act.<sup>40</sup> Most SROs do not have the broad aegis of the NASD regarding members' customer business, and so will not have a regulatory nexus to support a transaction fee applicable to other markets.

The NASD currently excludes debt, mutual funds, and variable annuities from the scope of the TAF, because of difficulties of measurement. The Commission urges the NASD to consider ways to take into account

activity in all the areas the NASD must oversee, to better allocate regulatory costs to these activities.<sup>41</sup>

Similarly, the Commission does not share the commenters' concern that the NASD could raise the TAF at any time. The NASD must file any proposed changes to the TAF with the Commission, and the NASD has agreed to file all future changes to the TAF for full notice and comment pursuant to section 19(b)(2) of the Act.<sup>42</sup> Therefore, if the NASD wishes to modify the TAF in the future, the NASD must file a proposed rule change pursuant to section 19(b)(2) of the Act,<sup>43</sup> for notice, public comment, and approval by the Commission.

In response to the commenters' concerns that the interpretations contained in *Notice to Members 02-63* and *Notice to Members 02-75* could be revoked or modified at any time, the NASD filed Amendment No. 3 to include the relevant language in the proposed rule language.

The Commission finds good cause for approving proposed Amendment Nos. 3 and 4 before the 30th day after the date of publication of notice of filing thereof in the **Federal Register**. The NASD filed Amendment Nos. 3 and 4 in response to comments it received after publication of the notice of filing of the proposed rule change, to address certain commenters' concerns. Because Amendment Nos. 3 and 4 are responsive to commenters' concerns, the Commission finds good cause for accelerating approval of the proposed rule change, as modified by Amendment Nos. 3 and 4.

The Commission expects that the NASD will continue to monitor the manner in which the TAF is implemented, and will take whatever steps are necessary to ensure that the fees remain consistent with the mandate established in section 15A(b)(5) of the Act,<sup>44</sup> so that the TAF remains

equitable, as well as consistent with the NASD's expressed goal.

## V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 3 and 4, including whether Amendment Nos. 3 and 4 are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to Amendment Nos. 3 and 4 that are filed with the Commission, and all written communications relating to Amendment Nos. 3 and 4 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 the NASD.

All submissions should refer to file number SR-NASD-2002-148 and should be submitted by June 27, 2003.

## VI. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>45</sup> that the proposed rule change (SR-NASD-2002-148), as modified by Amendment Nos. 1 and 2, be, and it hereby is, approved, and that Amendment Nos. 3 and 4 to the proposed rule change be, and hereby are, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>46</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>38</sup> The Commission notes that an SRO may not grant exemptions to its rules unless the SRO has Commission-approved rules that gives it the authority to do so. Furthermore, where such authority exists, an SRO must file a proposed rule change to grant an exemption, unless the circumstances for the exemption are truly unique. The NASD stated the exemption created by Amendment No. 4 will be implemented on January 1, 2004.

<sup>39</sup> 15 U.S.C. 78f(b)(5).

<sup>40</sup> 15 U.S.C. 78o-3(b)(5). In reviewing other similar fee proposals, the Commission will, as it has done here, examine the proposals to ensure that the costs borne by firms are commensurate with the functions performed.

<sup>41</sup> Although the NASD did not delineate its responsibility for regulating trading in the over-the-counter market in unlisted securities, the Commission believes that the NASD indeed shoulders such a responsibility, and that it should devote an appropriate portion of the TAF to expanding and enhancing its examination and surveillance programs in that particular area. In this connection, the Commission notes that it approved recently an NASD proposal that will give the NASD access to real-time quotation activity in such securities. See Securities Exchange Act Release No. 47587 (March 27, 2003), 68 FR 16328 (April 3, 2003) (SR-NASD-2000-42)(approval order). The Commission expects the NASD to devote appropriate resources to take advantage of this expanded information.

<sup>42</sup> 15 U.S.C. 78s(b)(2). See NASD Response Letter #2.

<sup>43</sup> 15 U.S.C. 78s(b)(2).

<sup>44</sup> 15 U.S.C. 78o-3(b)(5).

<sup>45</sup> 15 U.S.C. 78s(b)(2).

<sup>46</sup> 17 CFR 200.30-3(a)(12).