SIFMA
Securities Industry and
Financial Markets Association

January 23, 2008

Via Email and Overnight Mail

Ms. Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F St. NE
Washington D.C. 20549

Re: File No. SR-NASDAQ-2007-099 - Establishing Fees for Registering and Transferring Registration of Associated Persons

Dear Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] respectfully requests that the Securities and Exchange Commission ("SEC" or "Commission") abrogate the above-referenced filing pursuant to its authority under Section 19(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), on the ground that the registration fee increase proposed by the Nasdaq Stock Market LLC ("Nasdaq") does not satisfy the equitable allocation standards of Section 6(b)(4) of the Exchange Act. In addition, SIFMA further requests that the Commission review and address more generally the broader policy issue of regulatory fee increases currently imposed by other for-profit exchanges, as well as the Commission's own procedures for reviewing proposed exchange fee rules.

I. Executive Summary

On December 20, 2007, Nasdaq filed with the Commission a proposed rule change to impose a new $55 initial licensing fee for registered representatives of Nasdaq member firms, and an additional $55 fee for the transfer or re-licensing of a registered representative. Nasdaq filed this proposal for immediate effectiveness as of January 1,

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[1] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C. and London, and its associated firm, the Asian Securities Industry and Financial Markets Association, is based in Hong Kong.

2008, pursuant to Exchange Act Section 19(b)(3)(A)(ii) and Rule 19b-4(f)(2).[2] Notably, Nasdaq's rule filing does not provide any cost data or economic analysis to support the fee increase. Rather, Nasdaq simply asserts that:

> Nasdaq's market share in trading New York Stock Exchange securities has increased significantly and Nasdaq will also soon launch an options exchange. Both of these events create additional regulation expense that must be supported. Nasdaq believes that the new fees are warranted to ensure that fees for registered representatives fund a portion of the cost of regulating the Nasdaq market. Nasdaq believes that even with the new fees, registered representatives that are Nasdaq members will still generally pay less than or the same amount they pay to be registered representatives in other SROs.[3]

This filing raises substantial issues concerning the ability of for-profit exchanges to impose regulatory fee increases upon member firms.[4] Section 6(b)(4) of the Exchange Act requires the Commission to evaluate whether a proposed Nasdaq fee is consistent with the fair allocation standard articulated therein. As such, the Commission should examine the proposed fees in relation to the actual regulatory costs and expenses of the exchange. The Commission should not approve fee increases based on an exchange's unsubstantiated statement that it has "additional regulation expense that must be supported."

Where, as here, the exchange is a for profit enterprise that outsources nearly all of its regulatory functions to another Self Regulatory Organization ("SRO"), the exchange must be held to a standard of greater transparency and accountability when proposing new fees for its member firms. Otherwise, and in the absence of supporting regulatory expense information in the exchange's rule filing, there is no way of determining the extent to which the fees are in furtherance of a legitimate regulatory purpose or simply a means of providing a windfall to the exchange's shareholders at the expense of the investing public and member firms.[5]

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2 *See* SEC Release No. 34-57001 (December 20, 2007).

3 Id. at 2.

4 We note that the Commission currently has under consideration a petition by NetCoalition pertaining to market data fees and some of the same issues raised in that petition are presented here as well. See SEC Release No. 33-55011 (December 27, 2006).

5 SIFMA has raised these same points repeatedly in the related context of market data fees. See, Comment Letter on Regulation NMS from Marc Lackritz, President, SIA, to Jonathan Katz, Secretary, SEC (Feb. 1, 2005), File No. S7-1-04, at 25-31; Comment Letter on Regulation NMS from Marc Lackritz, President, SIA, to Jonathan Katz, Secretary, SEC (June 30, 2004), File No. S7-1-04, at 21-28; comment Letter on SRO Governance and Transparency Concept Release from Marc Lackritz, President, SIFMA, to Jonathan Katz, Secretary, SEC (March 9, 2005), File No. S7-39-04, at 16-19.

II. The Nasdaq Fee Filing is Inconsistent with Mandates of the Exchange Act And Therefore Should be Abrogated

A. Fair Allocation Requirements of Section 6(b)(4)

The Exchange Act expressly provides that an exchange's rules must "provide for the equitable allocation of reasonable dues, fees and other charges among its members and issuers and other persons using its facilities."[6] Permitting the Nasdaq fee increase to remain in effect would appear to increase Nasdaq's registration revenues by millions of dollars per year across the industry. Most of Nasdaq's members were already NASD members, and have already paid individual registrant fees to NASD. However, the split-off of Nasdaq from the NASD has now spawned an onerous new set of fees. We expect large firms to have potential cost increases of more than $1 million based on the new Nasdaq $55 per registrant fee. Firms would also pay additional fees as they newly register employees or hire previously registered personnel from other firms.

Notwithstanding the considerable economic impact the new fees will have on member firms, Nasdaq fails to demonstrate in its filing that these proposed fees have any reasonable relationship to its regulatory costs, or any corresponding increase in such costs. Rather, Nasdaq seeks to justify the fees by pointing to its increasing market share for NYSE-listed stocks and its anticipated launch of an options exchange. While Nasdaq claims that this business expansion creates "additional regulation expense," there is no explanation or cost analysis in the filing as to what these expenses consist of, how much money Nasdaq needs to defray these expenses, or how that sum compares to what it expects to raise through the fees it proposes. Nasdaq also states that its fee increase is comparable to registration fees charged by other exchanges.[7]

Nasdaq's justifications in the filing in support of the fee increase are not reasonably related to its regulatory costs and expenses (which are not disclosed in the filing). The increase in Nasdaq's market share in NYSE-listed securities carries with it increased revenues, such as market data tape revenues, that should more than offset the resulting increase in regulatory costs.[8] Similarly, Nasdaq's business decision to launch an options exchange in competition with the six other options exchanges represents its

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6 Exchange Act Section 6(b)(4).

7 This proposal is one of several in the past year in which various exchanges have raised or imposed regulatory fees (such as registration fees) without disclosing to the Commission or to the member firms any relationship (reasonable or otherwise) to the actual costs of its regulatory expenses. In all instances, these fee increases were filed for immediate effectiveness pursuant to Section 19(b) (3) (A) (ii) of the Exchange Act and Rule 19b-4(f) (2). See SEC Release No. 34-55899, 72 Fed. Reg, Vol. 72, No. 117 (June 19, 2007), SEC Release No. 34-57152, 73 Fed. Reg, Vol. 73, No. 14 (January 22, 2008).

8 Nasdaq's filing does not explain how increased volume in NYSE-listed securities causes a corresponding increase to its regulatory costs.

own attempt to increase its market-share, revenues, and profits, none of which have any relationship to Nasdaq's regulatory costs.[9]

The Commission has recognized that there is an inherent conflict of interest between SROs and their member firms with respect to funding, and that this conflict is exacerbated when SROs become for-profit enterprises.[10] That conflict is surely evident here. Nasdaq, a highly capitalized for-profit enterprise, has every economic incentive to maximize its profits. We believe that the proposed regulatory fees at issue here are an effort to maximize such profits.

We also question Nasdaq's claim that the increased fees are needed to subsidize its regulatory costs associated with its responsibilities as an exchange. Nasdaq itself engages in extremely limited self-regulatory activities. Nasdaq is not the Designated Examining Authority for any broker-dealer; that function is performed entirely by FINRA. Nasdaq outsources to FINRA its entire investigative and disciplinary process as well as its surveillance responsibilities concerning insider trading and other market abuses. The only market-related regulatory responsibility Nasdaq conducts itself is the MarketWatch department, which monitors for prices away from the current market and initiates trading halts — a regulatory function which Nasdaq's own annual report characterizes as "limited."[11] Importantly, from a cost perspective, any suspicious trading behavior detected by the Nasdaq MarketWatch staff is then referred to FINRA.

In its Concept Release on SRO Regulation, the Commission stated that regulatory fees should be "reasonably designed to recover the [SRO's] costs related to regulation and oversight of its members."[12] The Commission discussed its recent approval of the NASD's Trading Activity Fee, and noted that it would not approve a regulatory fee that "has little or no nexus to the regulatory tasks performed by the SRO."[13] Here, Nasdaq's regulatory functions on behalf of its members are minimal and its <u>disclosed</u> costs for self-regulation have not changed at all; indeed, as noted above, they are almost all outsourced.

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9 Significantly, as with equities, Nasdaq's options market will outsource virtually all of its regulatory responsibilities to FINRA and CBOE, both of whom will bear virtually all the costs associated with Nasdaq's business.

10 Concept Release Concerning Self-Regulation, SEC Release No. 34-50700 (Nov. 18, 2004) (hereinafter "Concept Release").

11 See Nasdaq 2006 Annual Report at 19 (available at http://www.shareholder.com/visitors/dynamicdoc/document.cfm?CompanyID=NDAQ&documentID=1826&PIN=&resizeThree=no&Scale=100&Keyword=type%20keyword%20here&Page=23) . Nasdaq has a separate regulatory function relating to its function of listing issuers for trading — but that function is funded by its resulting listing revenues. Finally, Nasdaq also has regulatory costs with respect to its broker-dealer subsidiaries — but it cannot justify charging its member firms (and the investing public) to subsidize broker-dealers which compete with those member firms.

12 Concept Release, in text accompanying note 204.

13 *Id.* at n.207 (citing Trading Activity Fee Approval Order, SEC Release No. 34-47946 (May 30, 2003)).

Nasdaq knows precisely what its regulatory costs are, whether through its contract with FINRA, or the small remaining cost of its MarketWatch staff. Accordingly, the Commission should require Nasdaq to document its regulatory costs, its existing regulatory revenues, and what it expects to earn from its proposed fee increase. The Commission then should make that information available for public notice and comment as part of the SRO rule approval process. Absent this data – all of which is readily quantifiable and available to Nasdaq – the Commission, member firms and investing public have no way of determining whether Nasdaq is in fact recovering its legitimate regulatory costs, or using its regulatory authority to cross-subsidize its competitive activities to the benefit its shareholders.

B. Efficiency, Competition and Capital Formation

The fee increase also should be abrogated because it does not promote efficiency, competition or capital formation, and therefore is inconsistent with the standard in Section 3(f) of the Exchange Act for SRO rules. The fee increase will impose multi-million dollar costs on the securities industry, costs that ultimately may be borne by the investing public. Contrary to Nasdaq's representation in its filing, we believe that the new fees may significantly harm investors and the public interest. A multi-million dollar increase in regulatory costs harms efficiency: such a tax on equity trading may be passed on to investors in the form of higher brokerage firm commissions and fees. Moreover, the new fees may harm capital formation. A tax on equity trading could drive some marginal investors out of the markets and thereby inhibit the listing of new issuers. A decrease in issuer listing activity because of increased regulatory costs for securities firms harms capital formation in the equity markets. Finally, because Nasdaq can use these regulatory fees to cross-subsidize its broker-dealer subsidiaries -- which compete directly against its member firms -- the fee increase could harm competition. Nasdaq has not provided to the Commission any data to suggest that its regulatory costs have risen by the multi-million dollar amount which the fee increase would provide to Nasdaq.

In light of the foregoing, SIFMA respectfully requests the Commission abrogate the instant filing and require, if Nasdaq wishes to continue to propose these fees, that they be accompanied by a transparent cost justification and be subjected to full public comment. Once Nasdaq does this, then the Commission can properly evaluate whether or not the fees are consistent with Exchange Act Section 6(b)(4) and other statutory provisions applicable to Nasdaq.

III. The Commission Should Address the Broader Policy Issues Presented by Regulatory Fees Charged by For-Profit Exchanges

Nasdaq's filing illustrates a larger issue. As stated earlier, the Commission recognized in the 2004 Self-Regulation Concept Release that there is an inherent conflict of interest when shareholder-owned, for-profit exchanges use the Commission's power to impose regulatory fees. Nearly four years after that release, virtually all U.S. exchanges have demutualized and have become for-profit enterprises, and all have imposed, or seek to impose, regulatory fees.[14]

For a number of years, the Commission has allowed exchanges to make fee filings for immediate effectiveness as long as the fees are to be paid only by the exchanges' members.[15] That differentiation may have been appropriate at a time when exchange boards of directors consisted largely of member firm representatives, on the theory that the members could prevent excessive fees from ever being approved at the exchange level before being submitted to the Commission as proposed rule changes. Upon the Commission's requiring exchanges to reduce substantially the member firm representation on their boards, however, that element of control was eliminated. The problem was further exacerbated when exchanges were allowed to go public and their economic incentives changed.

Today, for-profit exchanges owe fiduciary duties to their shareholders and not the investing public or their members. As a result, they are incentivized to maximize revenues, profits and shareholders' equity regardless of potential economic impact on the investing public or member firms. Those incentives differ with many aspects of the Exchange Act, making it all the more necessary that the Commission apply greater diligence to prevent overreaching such as the kind represented by the instant filing as well as those of other exchanges. For years the exchanges argued that protection from abuse was to be found "in the fact that those who approve the Exchange's budget and . . . fees are the ones who pay."[16] With the abolition of those protections, the Commission must apply greater scrutiny to safeguard against potential abuse.

Currently, the exchanges have not provided the Commission with the supporting cost information it needs to closely scrutinize these types of regulatory fees. On the contrary, the exchanges make no such specific disclosures, and instead justify their fees on the ground that other exchanges charge similar fees.[17] Allowing unchecked oligopolies to justify their prices by reference to the prices charged by other unchecked oligopolies is not an effective check against unfair and inequitable fees. Nor does this approach ensure that those prices are efficient, promote competition and will not harm capital formation. While we recognize that the Commission does not wish to engage in

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[14] The Boston Stock Exchange is the latest options exchange to file with the Commission a request to impose fees based on individual representatives. See SEC Release No. 34-57152, 73 Fed. Reg, Vol. 73, No. 14 (January 22, 2008).

[15] *See* SEC Release No. 34-35123 (December 28, 1994) in text at n.58.

[16] *Market Data: Implications to Investors and Market Transparency of Granting Ownership Rights over Stock Quotes: Hearing before the House Subcommittee on Capital Markets and Government Sponsored Enterprises of the House Committee on Financial Services*, 107th Cong. (2001) (statement of Richard P. Bernard, Vice President and General Counsel, NYSE).

[17] While a certain regulatory fee may have been appropriate to allow one exchange to cover its regulatory costs, the same fee may not have been appropriate for another exchange which traded different securities, with different technology, different members and a different cost structure.

"rate regulation," the Exchange Act requires a level of transparency and accountability by the exchanges before they are permitted to impose these types of fees on member firms.

Indeed, many of the issues raised by the Nasdaq filing are particularly relevant to fees charged by the other options exchanges. Generally, the options exchanges charge renewal fees based on the number of registered representatives at each member firm. Additional fees are charged for the initial registration and the termination of all those registered representatives. These fees are substantial and run into millions of dollars per year on an industry-wide basis.

SIFMA respectfully submits that there appears to be no direct relationship between the number of registered representatives at a member firm and the potential costs of regulating the options business conducted by that firm. Such costs are more likely related to the number or volume of options transactions effected by the firm on each exchange or the revenues earned by each firm from its options business. Moreover, now that FINRA is the primary SRO for all member firm regulation, the role of the options exchanges is principally limited to market regulation, and they continue to coordinate so that only one of them will inspect each member firm per year.[18] As such, uniform fees charged on a per individual representative basis do not appear to be reasonably related to the regulatory responsibilities remaining with the options exchanges.

SIFMA urges the Commission to require the exchanges to change their approach when proposing to impose or modify regulatory fees. Formerly, SROs argued that regulatory costs were spread across all their operations and were very difficult for them to separate and quantify. Whatever the merit of that argument in the past, today these expenses are typically the subject of clearly defined outsourcing agreements that presumably specify the precise outsourcing costs. The few remaining in-house SRO regulatory functions are well-defined and those costs also easily ascertainable (as is true for Nasdaq's MarketWatch department). Therefore, when filing a rule proposal to add or change a regulatory fee, each SRO should be obligated to disclose as part of its public filing exactly what its current regulatory costs and regulatory revenues are, and to estimate how the additional revenue to be generated from the proposed fee increase reasonably relates to those costs.

A collateral issue is whether the Commission can satisfy its statutory responsibility to measure fees against the Section 6(b)(4) standard by comparing an exchange's proposed fees with those charged by other exchanges. The Commission has for some time regarded exchange fees as being eligible for expedited approval, stating that:

> [I]f an SRO proposes a reasonable and relatively minor increase in an existing fee, or a proposal that is nearly identical to fees of other SROs,

18 Option exchanges no longer conduct sales practice examinations, though some might still conduct financial examinations that also cover books and records and a number of no-sales practice related areas.

> provided that the proposal does not raise other regulatory issues, such proposal would qualify under the noncontroversial category.[19]

SIFMA respectfully submits that although potentially efficient from an administrative perspective, this approach does not meet the standards in Section 6(b)(4). The Commission cannot effectively evaluate whether a particular exchange's fee meets the equitable allocation standard of Section 6(b)(4) by comparing it to the fees charged by other exchanges because these other exchanges may well have different cost structures, different membership configurations or other features that makes a simple fee-to-fee comparison inapt. In addition, there is no market test of any of these fees, particularly as charged by the larger exchanges since brokerage firms that have a substantial business find it necessary to join most if not all the national securities exchanges. Therefore, the Commission should not use this comparative approach as part of its evaluation of the exchange's filing.

IV. Conclusion

For the reasons set forth above, SIFMA respectfully requests that the Commission under its Section 19(b) authority abrogate the Nasdaq filing for a fee increase. Furthermore, we urge the Commission to require all exchanges who seek approval for regulatory fee changes to provide specific data about their regulatory costs and existing regulatory revenues and demonstrate the reasonable relationship between such costs and the fee changes. We appreciate the Commission's prompt attention to this important issue. If the Commission or the Staff would like to discuss this issue further with SIFMA, please contact the undersigned at (202) 962-7373 or Amal Aly at (212) 313-1268.

Respectfully submitted,

Ira D. Hammerman
Senior Managing Director and General Counsel

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Annette L. Nazareth, Commissioner
The Hon. Kathleen L. Casey, Commissioner
Dr. Erik R. Sirri Director, Division of Trading and Markets

[19] SEC Release No. 34-35123 (December 28, 1994) at n.59.

Robert L. D. Colby, Deputy Director, Division of Trading and Markets
Elizabeth King, Associate Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Marlon Paz, Special Counsel to the Director, Division of Trading and Markets
Brian G. Cartwright, General Counsel
Dr. James A. Overdahl, Chief Economist