

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53091; File No. SR-NSX-2005-10)

January 10, 2006

Self-Regulatory Organizations; National Stock Exchange; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change to Establish Certain Fees with Respect to Transactions Executed through the Intermarket Trading System

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> notice is hereby given that on December 30, 2005, the National Stock Exchange (“NSX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I and II below, which Items have been prepared by the NSX. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons, and is approving the proposal on an accelerated basis.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to enter into arrangements with other national securities exchanges to pass certain fees they have collected from members for transactions executed on another exchange through the Intermarket Trading System (“ITS”). This proposal does not require changes to NSX rule text.

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

In its filing with the Commission, the Exchange 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

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

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

in Item III below. The Exchange 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<sup>3</sup> requires each national securities exchange to pay the Commission a fee based on the aggregate dollar amount of certain sales of securities ("covered sales"). Rules 31 and 31T, adopted by the Commission in June 2004,<sup>4</sup> established procedures for the calculation and collection of Section 31 fees on such covered sales. Rule 31 requires each national securities exchange that owes Section 31 fees to submit a completed Form R31 to the Commission each month, beginning with July 2004. Rule 31T required each exchange to submit a completed Form R31 for each of the months September 2003 to June 2004, inclusive. Each national securities exchange must report its covered sales volume based on the data from a designated clearing agency, when available. The designated clearing agency for covered sales of equity securities is the National Securities Clearing Corporation ("NSCC"). These covered sales are reported in Part I of Form R31, and each exchange is required to "provide in Part I only the data supplied to it by a designated clearing agency."<sup>5</sup> The data supplied by NSCC for the period September 2003 through August 2004 did not accurately reflect the aggregate dollar value of the covered sales occurring on each exchange to permit reports to be made in accordance with new Rules 31 and 31T. In particular, the data NSCC reported to each national securities exchange included non-covered sales data for sales originating on one exchange and executed on another

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<sup>3</sup> 15 U.S.C. 78ee.

<sup>4</sup> See Securities Exchange Act Release No. 49928 (June 28, 2004), 69 FR 41060 (July 7, 2004) ("Adopting Release").

<sup>5</sup> 17 CFR 240.31(b)(5).

exchange through the ITS.<sup>6</sup>

Section 31 requires that national securities exchanges pay a fee based on the aggregate dollar amount of sales of securities transacted on the exchange. Given the specific language of Section 31, the Commission in the Adopting Release for Rules 31 and 31T advised that the current methodology for treating sales of securities that occur through ITS<sup>7</sup> was no longer appropriate and that “it would be simpler and more transparent for each covered [self-regulatory organization (“SRO”)] to report all covered sales that occur on its market.” The Commission further stated:

The Commission acknowledges that a covered SRO on which a covered sale occurs as a result of an incoming ITS order may not be able to collect funds to pay the Section 31 fee from one of its own members. However, Section 31 does not address the manner or extent to which covered SROs may seek to recover the amounts that they pay pursuant to Section 31 from their members. Covered

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<sup>6</sup> As a result of this and other inaccuracies in the data reported by NSCC, the national securities exchanges were unable to report accurate information on Form R31, unless they made adjustments to the NSCC data based on data other than that provided by NSCC. On October 6, 2004, the Commission’s Division of Market Regulation (“Division”) issued a “no-action” letter advising exchanges for whom NSCC acts as a designated clearing agency under Rule 31, that the Division staff would not recommend that the Commission take enforcement action if a national securities exchange adjusts the data provided by NSCC to accurately reflect covered sales occurring on the national securities exchange. See letter from Robert L.D. Colby, Deputy Director, Division, Commission to Ellen J. Neely, Senior Vice President and General Counsel, Chicago Stock Exchange, Inc. (“CHX”), dated October 6, 2004.

<sup>7</sup> In the Adopting Release, the Commission described the current methodology: “SRO A sends an ITS commitment to a member of SRO B to sell a security, and the commitment is executed on SRO B. Under existing arrangements, SRO A pays the Section 31 fee arising from this trade and passes the fee to its member that initiated the trade. ...[T]he SROs devised this system because SRO B does not have the ability to require members of SRO A to reimburse it for the cost of its Section 31 fees.” Adopting Release, 69 FR at 41067.

SROs may wish to devise new arrangements for passing fees between themselves so that the funds are collected from the covered SRO that originated the ITS order.<sup>8</sup>

The Commission further noted that any such arrangements devised by the SROs would have to be established pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder.

A subcommittee of the ITS Operating Committee<sup>9</sup> (“Subcommittee”) has had discussions in order to devise new arrangements for passing fees between the ITS participants that (1) were collected from their members for the months of September 2003 through August 2004; and (2) are being collected from their members beginning in September 2004 and continuing. This proposed rule change is being submitted by the NSX with the understanding that the other exchanges participating in the proposed arrangement devised by the subcommittee will be submitting substantially similar rule change proposals.<sup>10</sup>

Pursuant to the new arrangement being proposed, each ITS participant exchange determines whether it has received and executed more in dollar value of covered sales than it has originated and sent to each other ITS participant exchange. For example, for the historical period, September 2003 through August 2004, SRO A sent ITS commitments for covered sales whose dollar value was \$150 million to SRO B for execution. SRO A collected fees from its members to fund its Section 31 obligation for those covered sales executed on SRO B. SRO B,

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<sup>8</sup>

Id.

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The ITS participants are American Stock Exchange LLC, Boston Stock Exchange (“BSE”), Chicago Board Options Exchange, CHX, National Association of Securities Dealers (“NASD”), NSX, New York Stock Exchange (“NYSE”), Pacific Exchange, and Philadelphia Stock Exchange.

<sup>10</sup>

NASD has determined not to participate in the arrangement for passing fees between exchanges although they participated in many of the conference calls regarding the proposed arrangement.

as the executing market center, is obligated to pay the Section 31 fee to the SEC. During the same period, SRO B sent ITS commitments for covered sales whose dollar value was \$210 million to SRO A. SRO B collected fees from its members for those covered sales executed on SRO A. SRO A, as the executing market center, is obligated to pay the Section 31 fee to the SEC. Since SRO A executed a greater dollar value of covered sales from SRO B than it sent to SRO B, the proposed arrangement requires SRO A to determine the amount of the fees collected by SRO B from its members based on the aggregate dollar value of covered sales from SRO B and executed on SRO A through ITS commitments. When invoicing SRO B, SRO A will deduct the amount of the fee it owes to SRO B (i.e., the fee amount based on SRO A's \$210 million in aggregate covered sales less the fee amount based on SRO B's \$150 million in aggregate covered sales) and will invoice only for the difference of \$60 million.

Once the fees have been invoiced and paid for the historical period, the ITS participant exchanges plan to use the same arrangement for the period beginning September 2004 and continuing. It is anticipated that the invoicing process will occur twice yearly to coincide with the March 15 and September 30 payment schedule for Section 31 fees set forth in the Act.

To implement this proposed arrangement, an ITS participant exchange will require access to the aggregate dollar value of buy and sell transactions occurring through ITS. Under the proposed arrangement for fees collected for the months of September 2003 through August 2004, an ITS participant exchange may choose to use data obtained from the Inter-market Surveillance Information System ("ISIS") or data that provides comparable information that includes aggregate dollar value of ITS transactions.<sup>11</sup> The ISIS data is sorted by originating market center (i.e., the sender of an ITS commitment) and receiving market center (i.e., the market center that

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<sup>11</sup> The NYSE has made available to the ITS participants spreadsheets for each month in the period using the ISIS data.

executes the ITS commitment). Using this data, each ITS participant exchange can determine on a monthly basis the dollar value of all executed commitments sent to and received from another ITS participant exchange.

At its meeting on February 23, 2005, the Subcommittee asked the Securities Industry Automation Corporation (“SIAC”) to determine the time and expense involved for SIAC to use the ITS database that it maintains to provide reports of the aggregate dollar value of buy and sell transactions occurring through ITS to the ITS participants. On March 15, 2005, representatives of the Subcommittee authorized SIAC to develop new reports. SIAC is in the process of developing these reports and expects to complete testing by August 31, 2005. Once SIAC can provide this data, it will no longer be necessary for ISIS data to be used. The new reports provided by SIAC will be used by ITS participants in connection with determining which ITS participant exchange will pay the fee for transactions occurring through ITS and which ITS participant exchange has collected the fee from its members.

The NSX believes that the proposed arrangement is a fair and efficient means for passing fees collected at one ITS participant exchange based upon executions of covered sales occurring at another ITS participant exchange. The NSX acknowledges that the legal duty to report and pay the Section 31 fee remains with the ITS participant on which the sale was in fact transacted.

## 2. Statutory Basis

This proposal would establish a process for SROs to enter into arrangements to pass fees they have collected from members for transactions executed on another SRO through ITS. For these reasons, the Exchange believes that the proposed rule change is consistent with the Act and the rules and regulations thereunder that are applicable to a national securities exchange and, in

particular, the requirements of Section 6(b) of the Act.<sup>12</sup> Specifically, the Exchange believes the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,<sup>13</sup> in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices, and, in general, to protect investors and the public interest. In addition, the Exchange believes that the proposed rule change is consistent with the provisions of Section 6(b)(4) of the Act,<sup>14</sup> which requires that the rules of an exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

No written comments were solicited or received with respect to the proposed rule change.

III. 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. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

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<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> 15 U.S.C. 78f(b)(4).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSX-2005-10 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NSX-2005-10. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of the NSX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSX-2005-10 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of a Proposed Rule Change

After careful consideration, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national



securities exchange.<sup>15</sup> In particular, the Commission believes that the proposal is consistent with Section 6(b)(4) of the Act,<sup>16</sup> which requires that the rules of an exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities. National securities exchanges obtain funds to pay their Section 31 fees to the Commission by charging fees to broker-dealers who generate the covered sales on which Section 31 fees are based. An exchange can obtain most of these funds by imposing a fee on one of its members whenever the member is on the sell side of a transaction. However, when the exchange accepts an ITS commitment to buy, the ultimate seller is a party on another market. The exchange lacks the ability to pass a fee to that seller directly, because the seller may not be a member of the exchange. Under the proposed arrangement, which the Commission understands will be adopted by each of the ITS participant exchanges,<sup>17</sup> the exchange that routed the ITS commitment away will continue to collect a fee from the broker-dealer that placed the sell order. Then, with respect to each ITS participant exchange, the exchange will determine whether it is a net sender or net receiver of ITS trades and send fees to or accept fees from each other exchange accordingly. The Commission believes this is an equitable manner for the exchanges to obtain funds to pay their Section 31 fees on covered sales resulting from ITS trades.

Under Section 19(b)(2) of the Act,<sup>18</sup> the Commission may not approve any proposed rule change prior to the thirtieth day after the date of publication of the notice of filing thereof, unless

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<sup>15</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>16</sup> 15 U.S.C. 78f(b)(4).

<sup>17</sup> See letter from George W. Mann, Jr., Executive Vice President and General Counsel, BSE, and Chairman, Subcommittee, to Michael Gaw, Assistant Director, Division, Commission, dated September 29, 2005.

<sup>18</sup> 15 U.S.C. 78s(b)(2).

the Commission finds good cause for so doing. The Commission hereby finds good cause for approving the proposed rule change prior to the thirtieth day after publishing notice of filing thereof in the Federal Register. In this case, the Commission does not believe a comment period is necessary because all of the parties affected by the proposed fee – the other ITS participant exchanges – have already consented to and will adopt the same fee arrangement.<sup>19</sup>

For the reasons set forth above, the Commission finds good cause to accelerate approval of the proposed rule change pursuant to Section 19(b)(2) of the Act.<sup>20</sup>

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change (SR-NSX-2005-10) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

Nancy M. Morris  
Secretary

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<sup>19</sup> See supra note 17.

<sup>20</sup> Id.

<sup>21</sup> Id.

<sup>22</sup> 17 CFR 200.30-3(a)(12).