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**Securities and
Exchange
Commission**

**17 CFR Parts 240 and 249
Collection Practices under Section 31 of
the Exchange Act; Proposed Rule**

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-49104; File No. S7-05-04]

Collection Practices Under Section 31 of the Exchange Act

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing new procedures that would govern the calculation, payment, and collection of fees and assessments on self-regulatory organizations pursuant to section 31 of the Securities Exchange Act of 1934. Under these new procedures, a national securities exchange or national securities association would provide the Commission with data on its securities transactions, the Commission would calculate the amount of fees and assessments due based on the volume of those transactions, and the Commission would bill the national securities exchange or national securities association that amount.

DATES: Comments must be received by February 26, 2004.

ADDRESSES: To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. All comments concerning this proposal should be submitted in triplicate to Jonathan G. Katz; Secretary; U.S. Securities and Exchange Commission; 450 5th Street, NW., Washington, DC 20549-0609. Comments also may be submitted electronically to the following e-mail address: rule-comments@sec.gov. All comments should refer to File No. S7-05-04; this file number should be included on the subject line if e-mail is used. The Commission will make comment letters available for inspection and copying in its Public Reference Room at the same address. The Commission will post electronically submitted comments on its internet Web site (<http://www.sec.gov>). Personal identifying information, such as names or e-mail addresses, will not be edited from electronic submissions. Submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Michael Gaw, Special Counsel, 202-942-0158; or Christopher Solgan, Attorney, 202-942-7937; Division of Market Regulation; Securities and Exchange Commission; 450 5th Street, NW., Washington, DC 20549-1001.

SUPPLEMENTARY INFORMATION:

I. Background and Summary

Pursuant to Section 31 of the Securities Exchange Act of 1934 ("Exchange Act"),¹ the Commission collects fees and assessments on securities transactions occurring on national securities exchanges and by or through members of national securities associations (collectively, "self-regulatory organizations" or "SROs"). The largest source of the Commission's fee collections is Section 31 fees.² The Commission has not to date adopted formal rules prescribing procedures for the SROs to calculate the amount of their payments. The Commission recently completed a review of its collections policies and procedures in preparing its first audited financial statements.³ Based on that review, the Commission now believes that it is necessary and appropriate to propose rules to establish formal procedures. Therefore, the Commission is proposing to require the SROs to provide the Commission with data on all securities transactions subject to fees or assessments under Section 31 and to use that data to calculate the total amount due from each SRO.

II. Discussion

A. Requirements of the Statute

Paragraph (b) of Section 31 requires each national securities exchange to "pay to the Commission a fee [at a specified rate] of the aggregate dollar amount of sales of securities (other than bonds [and certain other enumerated securities]) transacted on such national securities exchange."⁴ Paragraph (c) requires each national securities association to "pay to the Commission a fee [at a specified rate] of the aggregate dollar amount of sales transacted by or through any member of such association otherwise than on a national securities exchange of securities (other than bonds [and certain other enumerated securities]) registered on a national

securities exchange or subject to prompt last sale reporting pursuant to the rules of the Commission or a registered national securities association."⁵ The fee rate established in paragraphs (b) and (c) is \$15 per \$1 million of the aggregate dollar amount of the subject sales,⁶ but paragraph (j) of Section 31⁷ directs the Commission to adjust the fee rate if certain criteria are met.

Paragraph (d) requires each national securities exchange and national securities association to "pay to the Commission an assessment⁸ equal to \$0.009 for each round turn transaction (treated as including one purchase and one sale of a contract of sale for future delivery) on a security future traded on such national securities exchange or by or through any member of such association otherwise than on a national securities exchange."⁹

Paragraph (e) stipulates that the fees required by paragraphs (b) and (c) and the assessments required by paragraph (d) of Section 31 shall be paid: "(1) on or before March 15, with respect to transactions and sales occurring during the period beginning on the preceding September 1 and ending at the close of the preceding December 31; and (2) on or before September 30, with respect to transactions and sales occurring during the period beginning on the preceding January 1 and ending at the close of the preceding August 31."¹⁰

Paragraph (f) provides that "[t]he Commission, by rule, may exempt any sale of securities or any class of sales of securities from any fee or assessment imposed by this section, if the Commission finds that such exemption is consistent with the public interest, the equal regulation of markets and brokers and dealers, and the development of a national market system."¹¹ The Commission has exercised this authority to create exemptions for several types of transactions. These exemptions are

¹ 15 U.S.C. 78ee.

² The Commission anticipates that, consistent with federal agency financial accounting practices, these fees and assessments will be treated as "revenue" in the Commission's financial statements. Section 31(i) of the Exchange Act, 15 U.S.C. 78ee(i), requires that the fees and assessments collected by the Commission be "deposited and credited as offsetting collections to the account providing appropriations to the Commission." The Commission can spend fees only to the extent Congress allows.

³ The Accountability of Tax Dollars Act of 2002, Pub. L. 107-289, 31 U.S.C. 3515, now requires each Federal executive agency with appropriated budget authority of more than \$25 million to prepare annual audited financial statements. The Commission is subject to this requirement.

⁴ 15 U.S.C. 78ee(b).

⁵ 15 U.S.C. 78ee(c).

⁶ In addition, paragraph (h) of Section 31, 15 U.S.C. 78ee(h), provides that "[t]he rates per \$1,000,000 required by this section shall be applied pro rata to amounts and balances of less than \$1,000,000."

⁷ 15 U.S.C. 78ee(j).

⁸ Funds collected by the commission pursuant to paragraphs (b) and (c) of section 31 are termed "fees," while funds collected pursuant to paragraph (d) are termed "assessments." The term "Section 31 fees" will be used throughout this release to refer to both fees and assessments.

⁹ 15 U.S.C. 78ee(d). For fiscal year 2007 and each succeeding fiscal year, the assessment will be \$0.0042 for each such transaction. *See id.*

¹⁰ 15 U.S.C. 78ee(e).

¹¹ 15 U.S.C. 78ee(f).

codified in existing Rule 31-1 under the Exchange Act.¹²

B. Existing Practices under Section 31

The statute does not stipulate how the "aggregate dollar amount of sales"—as used in paragraphs (b) and (c) of Section 31—is to be calculated or who should do the calculation. The Commission has not previously defined this term by rule or mandated a formal procedure whereby the SROs must calculate and pay their Section 31 fees, instead permitting the SROs to develop their own procedures. As a result, the SROs have developed various means for determining the amounts owed:

- Two exchanges, the New York Stock Exchange ("NYSE") and the American Stock Exchange ("Amex"), rely on a practice known as "self-reporting." The exchanges do not independently calculate the aggregate dollar amount of sales on which they owe Section 31 fees. Instead, they rely on each clearing member firm to "self-report" the aggregate dollar amount of its sales, to multiply that amount by the fee rate, and to pay the exchange the resulting amount due. Each exchange aggregates the funds submitted by its clearing member firms and forwards this sum to the Commission.

- The National Association of Securities Dealers ("NASD") determines the "aggregate dollar amount of sales" based on the transaction volume reported by NASD members to the Automated Confirmation Transaction Service ("ACT"). The NASD multiplies each clearing member's amount of sales by the fee rate and bills the member the result. However, the ACT data do not capture all sales on which Section 31 fees are due. Therefore, the NASD relies on member self-reporting with respect to certain odd-lot sales (*i.e.*, sales involving fewer than 100 shares), sales occurring in the Alternative Display Facility ("ADF"),¹³ and sales resulting

from the exercise of an over-the-counter option.

- The other equities exchanges calculate the aggregate dollar amount of sales that are subject to Section 31 fees based on the amount of each clearing member's transactions that are reported to the consolidated tape.¹⁴ The exchange multiplies that amount by the fee rate and bills each clearing member the resulting amount due. The exchange aggregates the funds collected from its clearing members and forwards this sum to the Commission.

- The Options Clearing Corporation ("OCC") pays Section 31 fees on behalf of the five options exchanges and Section 31 assessments on behalf of the two security futures exchanges. OCC calculates the aggregate dollar amount of sales, and the total number of round turn transactions on security futures, of each clearing member that is also an OCC participant and multiplies that number by the applicable rate under Section 31. OCC then deducts the amounts due for those transactions from each participant account, aggregates the funds collected from the participants, and forwards the sum to the Commission. OCC submits a single lump-sum payment to the Commission on behalf of these seven exchanges. OCC does not stipulate the amount paid on behalf of each exchange.

The Commission believes that the current arrangements may create uncertainties about whether the proper amounts due pursuant to Section 31 are being paid to the Commission. With proposed Rules 31 and 31T and Form R31, the Commission seeks to establish the total amounts payable under Section 31 with more reliable methods.

C. Definition of Terms Used in Proposed Rule 31

The proposed rule would require national securities exchanges and national securities associations to provide data on all of their securities transactions that are subject to Section 31. Based on that data, the Commission would calculate the amount owed by each SRO and issue bills twice per year.¹⁵ Proposed Rule 31 would define

reached. in response to these concerns, the NASD agreed to provide an alternative quotation and transaction reporting facility (now the ADF) that would, in effect, make participation in SuperMontage voluntary. See 66 FR at 8024. the ADF permits NASD members to comply with their obligations under Commission and NASD rules (including Rule 11Ac1-1(c)(5) under the Exchange Act, 17 CFR 11Ac1-1(c)(5), and Regulation ATS, 17 CFR 242.300 *et seq.*) without participating in SuperMontage.

¹⁴ See *infra* note 21.

¹⁵ See Section 31(e) of the Exchange Act, 15 U.S.C. 78ee(e) (establishing two annual due dates for Section 31 fees).

and interpret certain terms used in the statute and create and define other terms to facilitate the new procedures.

Proposed Rule 31 would introduce the concepts of "covered sales" and "covered round turn transactions." A covered sale would be a securities transaction subject to fees pursuant to paragraphs (b) or (c) of Section 31. As such, the term would not include any transactions in security futures, which are subject to assessments pursuant to paragraph (d) of Section 31. Paragraph (a)(6) of proposed Rule 31 would define "covered sale" to mean a sale of a security, other than an "exempt sale" or a sale of a security future, occurring on a national securities exchange or by or through any member of a national securities association otherwise than on a national securities exchange. The term "exempt sale," defined in paragraph (a)(11) of proposed Rule 31, would include a sale exempted from fees by Section 31 itself or a sale that the Commission previously has exempted by rule.

A "covered round turn transaction" would be a securities transaction on which an assessment is owed pursuant to paragraph (d) of Section 31. Paragraph (a)(7) of proposed Rule 31 would define "covered round turn transaction" to mean a round turn transaction on a security future, other than a round turn transaction in a future on a narrow-based security index, occurring on a national securities exchange or by or through any member of a national securities association otherwise than on a national securities exchange. Paragraph (a)(14) of proposed Rule 31 would define "round turn transaction on a security future" as one purchase and one sale of a contract of sale for future delivery.

Proposed Rule 31 would impose a new duty on "covered SROs" to report to the Commission data on all of their covered sales and covered round turn transactions. The term "covered SRO" would include "covered exchanges" and "covered associations." Paragraph (a)(5) of proposed Rule 31 would define "covered exchange" to mean a national securities exchange on which covered sales or covered round turn transactions occur. Currently, there are 11 national securities exchanges that would be covered exchanges under proposed Rule 31:

- Nine national securities exchanges registered pursuant to Section 6(a) of the

¹² 17 CFR 240.31-1. See also Securities Exchange Act Release No. 12624 (July 14, 1976), 41 FR 30587 (July 26, 1976) (adopting what are currently paragraphs (a) through (e) of rule 31-1); Securities Exchange Act Release No. 45371 (January 31, 2002), 67 FR 5199 (February 5, 2002) (adopting what are currently paragraphs (f) and (g) of rule 31-1).

¹³ The ADF is a pilot program that the NASD operates members that choose to quote or effect trades in Nasdaq securities otherwise than on the Nasdaq Stock Market or an exchange. See Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49821 (July 31, 2002) (approving ADF pilot). The Commission conditioned its approval of the SuperMontage facility on the NASD's establishment of the ADF. See Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001). In the SuperMontage proposal, several commenters expressed concern that SuperMontage would become the only execution system through which substantially all displayed trading interest in the over-the-counter ("OTC") markets could be

Exchange Act¹⁶ that may trade any type of security;¹⁷ and

- Two national securities exchanges registered pursuant to Section 6(g) of the Exchange Act¹⁸ that may trade no securities other than security futures.¹⁹ Paragraph (a)(4) of proposed Rule 31 would define “covered association” to mean any national securities association by or through any member of which covered sales or covered round turn transactions occur otherwise than on a national securities exchange. Currently, there is one national securities association, the NASD, that would be a covered association under the proposed rule.²⁰

D. Collecting Data on Covered Sales and Covered Round Turn Transactions

To calculate the fees owed by each covered SRO pursuant to Section 31, the Commission would need to know the aggregate dollar amount of each SRO’s covered sales. Unfortunately, there is currently no single source for this information. As described below, covered sales are reported, cleared, and settled in a variety of ways and data on covered sales exist in a variety of sources. Proposed Rule 31 and Form R31 would attempt to capture relevant information about all covered sales through the most reliable of the available sources. Data on covered round turn transactions could, however, be obtained from a single source.

1. Post-Trade Processing Generally

a. Equities

i. Exchange Trades of Equity Securities

A trade occurring on an exchange generally must be reported to that exchange for dissemination to the public and to begin the process of clearance and settlement. Exchanges

have automated systems to receive and process these reports. If a trade occurs on a trading floor, exchange rules generally require both the buyer and the seller to submit a record of the trade to the exchange. The exchange attempts to match the records submitted by the buyer and the seller and to resolve any discrepancies (e.g., in size or price). If the trade occurs through an electronic execution system of the exchange, the system “locks” a buy and a sell order together to create the trade, and further action generally is not necessary since all relevant details about the orders and the counterparties have already been entered into the system.

Once a record of a locked-in, two-sided transaction has been established, the exchange reports the trade to a system known as the “consolidated tape.”²¹ In addition, the exchange generally submits a record of its locked-in transactions to a clearing agency registered with the Commission under Section 17A of the Exchange Act²² for clearance and settlement. The National Securities Clearing Corporation (“NSCC”) clears and settles transactions in debt and equity securities (other than security futures), and OCC clears and settles transactions in options and security futures.

The exchanges usually forward to the appropriate registered clearing agency a record of each individual locked-in transaction, even if a particular transaction would not result in any net change in the accounts maintained by the clearing agency.²³ If a transaction is

subsequently broken²⁴ or recorded in error, the SRO on which the transaction occurred would submit a second instruction (generally known as a “reversal”) to the clearing agency to delete the earlier record. If the details of the trade were revised, the exchange would then submit a third instruction showing the corrected information. If the trade were canceled, no additional instruction would be submitted.

There are a few exceptions to the general rule that the exchanges report all of their transactions to a clearing agency. For example, some exchanges have rules that allow their members to clear and settle transactions outside of the regular clearing system (so-called “ex-clearing” transactions).²⁵ As their name indicates, such trades are not reported to a clearing agency. The Commission has been informed that the number of ex-clearing transactions occurring on the exchanges is very small.

In addition, an exchange may allow an entity known as a “qualified special representative” (“QSR”) to report certain equity trades directly to NSCC for clearing. A QSR is an NSCC member that operates, has an affiliate that operates, or clears for a broker-dealer that operates, an automated execution system where the NSCC member is on the contraside of every transaction.²⁶ NSCC rules do not prohibit a QSR from summarizing and netting its trades before reporting to NSCC, resulting in fewer reports to NSCC and a corresponding reduction in the amount

²⁴ Exchanges often have rules that allow a trade to be “broken” or voided in certain circumstances. See, e.g., Amex Rule 135 (Cancellation of, and Revisions in, Transactions); PCX Equities Rule 7.11 (Clearly Erroneous Policy); ISE Rule 720 (Obvious Errors).

²⁵ See, e.g., Amex Rule 722 (Comparison of Transaction Through a Registered Clearing Agency) (“This rule shall not apply if it is stipulated in the bid or offer that a transaction is to be completed ex-clearing or if it [sic] otherwise agreed by the parties thereto”); NYSE Rule 130(c) (Overnight Comparison of Exchange Transactions) (“each member or member organization which is a party to the contract shall submit, or cause to be submitted, such trade data as may be required by the Exchange or the Qualified Clearing Agency it selects, in such form as the Exchange or the Qualified Clearing Agency shall prescribe, . . . in the case where a Qualified Clearing Agency will not be used to compare or settle the transaction, to the party or parties on the other side of the trade”); PHLX Rule 6 (Trade Reporting and Confirmation of Transactions) (“SCCP shall transmit all Participant transactions, except ex-clearing transactions, to NSCC for clearance and settlement”); PHLX Rule 11 (Ex-Clearing Accounts) (“In an Ex-Clearing Account, SCCP records and confirms a transaction, whereby both sides have agreed to settle the transaction outside any registered clearing agency mechanism”).

²⁶ See NSCC Rule 39. As discussed below, QSRs also may report to NSCC equity trades occurring in the over-the-counter market.

²¹ The consolidated tape—which derives its name from its historical antecedent, the tickertape—refers to a set of three regulatory plans established by the SROs and approved by the Commission pursuant to Section 11A of the Act, 15 U.S.C. 78k-1, and Rule 11Aa3-2 thereunder, 17 CFR 240.11Aa3-2: (1) The Consolidated Tape Association (“CTA”) plan for equity securities listed on the NYSE, Amex, and the regional equities exchanges that meet Amex listing criteria; (2) the OTC/UTP plan for securities listed on the Nasdaq Stock Market; and (3) the Options Price Reporting Authority plan for exchange-listed options. These plans require individual SROs to transmit information to a processor, which consolidates the information for dissemination to vendors. The vendors, in turn, disseminate the information to the public.

²² 15 U.S.C. 78q-1.

²³ Generally, only broker-dealers, banks, and other institutions are permitted to have accounts with a registered clearing agency. Therefore, a customer’s interest in a particular security is created by a record on the books of its broker-dealer, not by a record kept by the clearing agency. If the orders of two customers who have the same broker-dealer are executed against each other or “cross,” the customers’ accounts held by the broker-dealer would be adjusted to effect the transaction. The clearing agency, on the other hand, would take no action to effect the transaction because there is no net change in position in the account of the broker-dealer held at the clearing agency.

¹⁶ 15 U.S.C. 78f(a).

¹⁷ These exchanges are Amex, the Boston Stock Exchange (“BSE”), the Chicago Board Options Exchange (“CBOE”), the Chicago Stock Exchange (“CHX”), the International Securities Exchange (“ISE”), the National Stock Exchange (“NSX”) (formerly known as the Cincinnati Stock Exchange), the NYSE, the Pacific Exchange (“PCX”), and the Philadelphia Stock Exchange (“PHLX”).

¹⁸ 15 U.S.C. 78f(g).

¹⁹ These exchanges are NQLX and OneChicago.

²⁰ The National Futures Association (“NFA”) is also registered with the Commission as a national securities association, but it would not be a “covered association” under proposed Rule 31. The only securities that NFA members trade are security futures. Currently, all trading in security futures occurs on the national securities exchanges. These exchanges incur liability to the Commission for such transactions under paragraph (d) of Section 31. There are no transactions in security futures by or through an NFA member otherwise than on a national securities exchange. Therefore, the NFA itself does not incur any liabilities under Section 31 and would not, therefore, be considered a covered association.

of the QSR's clearing fees. NSCC records the net changes in positions and moves funds and securities between accounts of NSCC members accordingly, but it is unlikely to have a record of each of the trades underlying the QSR report.

ii. OTC Trades of Equity Securities

In the OTC market in equities, trades generally must be reported to either ACT or—if the transaction occurs in the ADF—to the Transaction Reporting and Comparison Service (“TRACS”). ACT is a transaction reporting and comparison system operated by the Nasdaq Stock Market,²⁷ which is currently a subsidiary of the NASD.²⁸ If a trade occurs through a Nasdaq execution system, the system automatically forwards to ACT a record showing a locked-in, two-sided transaction. Otherwise, NASD rules specify which party must report the trade to ACT, when the party must report it, and what information about the trade must be included.²⁹ Upon receiving data from NASD members, ACT attempts to lock in the trade.³⁰ If a record of a locked-in, two-sided transaction is established, ACT can forward the trade to NSCC for clearance and settlement. However, because of the nature of OTC trading, some transactions reported to ACT are not submitted by ACT to NSCC. Internalized trades, for example, are generally not reported to NSCC even though they must be reported to ACT.³¹ In addition, an NASD member may instruct ACT not to report a trade to NSCC if the trade will be reported to NSCC directly by a QSR.

ACT is the trade reporting system for all OTC equity markets except for the ADF. The NASD has developed a separate trade reporting system, known as TRACS, for trades occurring in the ADF. TRACS is modeled after and operates in a manner similar to ACT.³²

²⁷ See NASD Rule 6110(d).

²⁸ Nasdaq has submitted an application to register as a national securities exchange. See Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001). If the Commission approves this application, Nasdaq would separate from the NASD.

²⁹ See NASD Rule 6110 Series. However, NASD rules do not require that odd-lot trades be reported to ACT.

³⁰ See NASD Rule 6140 (describing four methods by which ACT will attempt to match the trade information submitted by the reporting parties).

³¹ An internalized trade occurs, for example, when a broker-dealer, to satisfy a customer order to buy, transfers securities between its proprietary account and the account that it holds on behalf of the customer. Because an internalized trade results in no net change in the position of the broker-dealer's NSCC account, there is no reason to report it to NSCC.

³² See NASD Rule 5400 Series.

b. Options and Security Futures

The process whereby reports of transactions in options and security futures are matched and locked in is very similar to that for equity trading on the exchanges. The post-trade processing of options and security futures trading on national securities exchanges differs slightly, however, in that the exchanges forward reports of all such trades to a registered clearing agency (OCC), whereas with equities some trades are not reported to NSCC by the exchange itself (in the case of trades reported to a designated clearing agency by a QSR) or not reported at all (in the case of ex-clearing trades). Exchange-listed options and security futures do not trade over-the-counter; therefore, no national securities association would incur a liability to the Commission under Section 31 for such trading.

In addition, some non-exchange-listed options trade over-the-counter, but a national securities association would not incur any liability to the Commission under Section 31 for such trading because OTC options are not “registered on a national securities exchange or subject to prompt last sale reporting pursuant to the rules of the Commission or a registered national securities association.”³³ Section 6(h)(1) of the Exchange Act makes it illegal to trade security futures that are not listed on a national securities exchange;³⁴ therefore, no trading of such security futures occurs over-the-counter and no national securities association incurs Section 31 liability for such trading.

2. Additional Terms Defined in Proposed Rule 31

One of the primary sources of data on covered sales and covered round turn transactions under the proposed rule would be the “designated clearing agencies.” Paragraph (a)(9) of proposed Rule 31 would define “designated clearing agency” to mean any clearing agency registered under Section 17A of the Exchange Act³⁵ that clears and settles covered sales or covered round turn transactions. Presently, there are two entities that would be designated clearing agencies under the proposal: NSCC and OCC.

³³ Section 31(c) of the Exchange Act, 15 U.S.C. 78ee(c). A national securities association would, however, incur a liability for the exercise of an OTC option if the exercise resulted in the sale of a security that is “registered on a national securities exchange or subject to prompt last sale reporting pursuant to the rules of the Commission or a registered national securities association.” See *infra* Section D(3)(a).

³⁴ See 15 U.S.C. 78f(h)(1).

³⁵ 15 U.S.C. 78q-1.

The Commission believes that clearing data obtained from the designated clearing agencies would provide a sound basis for the calculation of Section 31 fees for the covered exchanges. Market participants have a strong incentive to ensure the accuracy of the trade data reported to the clearing agencies; without accurate data, the clearing agencies cannot move the correct amount of funds and securities between participant accounts to settle transactions. The Commission anticipates that the vast majority of covered sales occurring on the covered exchanges would be captured by the clearing data available from the designated clearing agencies.

In situations where clearing agency data is incomplete (in the case of trades reported to a designated clearing agency by a QSR) or nonexistent (in the case of ex-clearing trades), the Commission would have to rely on other sources. One such source would be a covered SRO's “trade reporting system.” Paragraph (a)(16) of proposed Rule 31 would define “trade reporting system” to mean an automated facility of a covered SRO used to collect or compare trade data. Only automated facilities fall within the definition; a predominantly paper-based system for collecting or comparing trade data, such as the reporting system currently used by NASD members to report their odd-lot transactions to the NASD, would not be considered a “trade reporting system.” A covered SRO might have more than one trade reporting system.³⁶

Paragraph (e) of Section 31 stipulates that fees and assessments are due twice each year: (1) March 15, for sales and transactions “occurring” during the period beginning on the preceding September 1 and ending at the close of the preceding December 31; and (2) September 30, for sales and transactions “occurring” during the period beginning on the preceding January 1 and ending at the close of the preceding August 31. A securities transaction can take several days to complete, from the day that a binding contract to trade is established to the day that funds and securities move between accounts to settle the transaction. Section 31 does not identify on which date during the process a transaction “occurs,” although the statute suggests that a single date must be selected in order to assign every transaction to one of the billing periods. For example, liability for a sale that is negotiated on August 30 but does not

³⁶ For example, ACT and TRACS, operated by the NASD, would both be considered trade reporting systems under the proposal.

settle until September 2 must be assigned to only one billing period.

Proposed Rule 31 introduces the concept of the "charge date" to clarify this issue. Paragraph (a)(3) of proposed Rule 31 would define the charge date as the date on which a covered sale or covered round turn transaction occurs for purposes of determining the liability of a covered SRO pursuant to Section 31 of the Exchange Act. The charge date could be either the trade date or the settlement date; as discussed below, the date to be used would depend on the manner in which the trade is reported and cleared. The charge dates set forth in proposed Rule 31 would largely codify the existing practices of the SROs.

3. Proposed Form R31

Paragraph (b)(1) of proposed Rule 31 would require covered SROs to submit to the Commission proposed Form R31 within ten business days after the end of each month.³⁷ The form would require a covered SRO to report data on all of its covered sales having a charge date in the month of the report. This data would be derived from different sources. The dollar amounts of sales captured by each separate source would be added to provide a single figure for the aggregate dollar amount of the SRO's covered sales for the month. Paragraph (b) of proposed Rule 31 also would require covered SROs to provide the total number of its covered round turn transactions having a charge date in the month of the report.

Proposed Form R31 would be organized as follows:

a. Part I

In Part I of proposed Form R31, a covered exchange would be required to report the aggregate dollar amount of the covered sales that: (1) occurred on the

exchange; (2) have a charge date in the month of the report; and (3) the exchange itself reported to a designated clearing agency. The form would require covered exchanges to make separate entries for sales of equities and sales of options. Each covered exchange also would be required to report the total number of covered round turn transactions that: (1) occurred on the exchange; (2) have a charge date in the month of the report; and (3) the exchange reported to a designated clearing agency.

In addition, paragraph (b)(3)(i) of proposed Rule 31 would require a covered association to report in Part I the aggregate dollar amount of covered sales that: (1) occurred by or through any of the association's members; (2) have a charge date in the month of the report; and (3) resulted from an exercise³⁸ of a "physical delivery exchange-traded option."³⁹ The Commission acknowledges that this arrangement would represent a departure from current practices. Presently, Section 31 fees attributable to sales of securities resulting from the exercise of physical delivery exchange-traded options are paid to the Commission by OCC, through a voluntary arrangement between OCC and the options exchanges. When OCC receives notice that an option held in the account of one of its participants is being exercised, OCC instructs NSCC to move funds and securities between NSCC accounts to effect the exercise. OCC also deducts the corresponding Section 31 fees from participant accounts held at OCC.⁴⁰ OCC combines

the fees that it collects for sales of securities resulting from exercises of physical delivery exchange-traded options and includes this sum as part of its aggregate payment to the Commission of Section 31 fees. However, OCC does not and has informed Commission staff that it currently is not able to attribute these exercises to any particular exchange.

The Commission believes that it is not appropriate for Section 31 fees on sales of securities resulting from the exercises of physical delivery exchange-traded options to be combined into a single payment that obscures the SRO on whose behalf the payment is being made. Therefore, proposed Rule 31 would clarify that the covered association by or through the members of which such sales occur—presently the NASD—would be required to report data on such covered sales and pay the corresponding Section 31 fees.

The Commission believes that this approach is consistent with paragraphs (b) and (c) of Section 31. Paragraph (b) requires a national securities exchange to pay Section 31 fees on "sales of securities * * * transacted on such national securities exchange," while paragraph (c) requires a national securities association to pay fees on "sales transacted by or through any member of such association otherwise than on a national securities exchange." The Commission does not believe that a sale of a security resulting from the exercise of a physical delivery option can be viewed as being "transacted on [a] national securities exchange."⁴¹ As noted above, the terms of the sale are not negotiated on or through the facilities of an exchange, but rather through the terms of the previously agreed options contract. Nor is the sale executed on or through the facilities of an exchange, since the sale is effected through instructions communicated by the holder of the option to OCC and by OCC to NSCC. The Commission believes, rather, that such sales occur "otherwise than on a national securities

(\$20/share × 1000 shares). OCC instructs NSCC to move \$20,000 from Y's NSCC account to X's NSCC account and to move 1000 shares of ABC from X's NSCC account to Y's NSCC account. OCC also deducts a fee from X's OCC account in the amount of \$20,000 times the Section 31 fee rate in effect when the exercise occurs.

⁴¹ 15 U.S.C. 78ee(b). The party required to sell shares as a result of the exercise (the holder in case of a put or the writer in case of a call) might have to purchase the underlying securities to have sufficient inventory to perform its obligations under the option contract. This purchase could occur on a national securities exchange and be subject to fees under paragraph (b) of Section 31. Nevertheless, the exercise itself (i.e., the transfer of shares between the writer and the holder of the option) is a separate transaction for purposes of Section 31.

³⁷ In light of the billing cycle established by paragraph (e) of Section 31, the Commission preliminarily believes that ten business days would be an appropriate length of time to allow covered SROs to complete and submit proposed Form R31. One of the billing dates established by paragraph (e) of Section 31 is September 30, covering the period January 1 to August 31. There are only 30 calendar days in the month of September and, depending on when the weekends fall, perhaps only 19 to 21 business days. In addition, a federal holiday—Labor Day—always falls in the month of September. The Commission believes that covered SROs should have at least a few business days between the receipt of their Section 31 bills and the September 30 due date in order to process their payments. In addition, the Commission must have at least a few business days to calculate the total amounts due from the covered SROs under Section 31 and prepare the bills. For the Commission to perform these calculations in a timely manner, it would need the data to be supplied in proposed Form R31 by roughly the middle of September (i.e., ten business days after August 31, the close of the billing period).

³⁸ The sale of an option must be distinguished from the exercise of an option. Each event could separately lead to a liability being created under Section 31 of the Exchange Act.

³⁹ Paragraph (a)(15) of proposed Rule 31 would define "physical delivery exchange-traded option" as a securities option that is listed and registered on a national securities exchange and settled by the physical delivery of the underlying securities. Options are of two general types: cash-settled and physical delivery. Only the exercise of an option settled by physical delivery could result in a covered sale. Upon the exercise of such an option, one party must sell to the other party (at the strike price) the underlying securities to fulfill the option contract. Such sale could create liability for an SRO pursuant to Section 31 of the Exchange Act. With a cash-settled option, however, there is no sale of securities upon exercise. The option is settled by payment of the difference between the strike price and the market price of the underlying security or security index. Such payment is not subject to Section 31.

⁴⁰ For example, assume that X is long 10 put options and Y is short 10 put options, and that both X and Y hold accounts at OCC and NSCC. The security underlying the options is ABC, the strike price is \$20, and the options are settled through physical delivery. X elects to exercise the put options and the exercise is assigned to Y. Y now must buy from X 1000 shares of ABC (10 puts × 100 shares underlying each put) for a price of \$20,000

exchange” within the meaning of paragraph (c) of Section 31, thereby creating liability on the part of the NASD. Therefore, the Commission is proposing to require the NASD to report in Part I of proposed Form R31 the aggregate dollar amount of covered sales resulting from the exercise of physical delivery exchange-traded options.⁴²

Paragraph (a)(4) of proposed Rule 31 would provide that, for a covered sale or covered round turn transaction included in the data reported in Part I by a covered exchange, the charge date would be the settlement date. Part I data would be supplied by a designated clearing agency, the primary function of which is to clear and settle securities transactions and which will, of course, know the settlement date of a transaction. By contrast, a designated clearing agency might have to develop new procedures to track and record transactions by trade date. Accordingly, the Commission believes that it would be more practical for the designated clearing agencies to provide data on covered sales and covered round turn transactions based on the settlement date.

However, paragraph (a)(4) also provides that a covered sale resulting from the exercise of a physical delivery exchange-traded option would use the trade date as the charge date. In this case, the trade can be viewed as occurring when OCC sends an instruction to NSCC to move funds and securities between NSCC participant accounts to effect the exercise. The Commission believes that the alternative—for OCC to build systems to monitor when settlement at NSCC is complete—would be impractical. Therefore, the Commission believes that trade date should be used in this instance for the charge date.

b. Part II

In Part II, a covered exchange would be required to provide the aggregate dollar amount of the covered sales that: (1) occurred on the exchange; (2) have a charge date in the month of the report; and (3) it captured in a trade reporting system but does not report to a designated clearing agency.⁴³ For example, a covered exchange that permits “ex-clearing” trades would report such trades—provided they meet

⁴² However, as discussed below, OCC would be obligated by proposed Rule 31 to provide the NASD with the data in its possession needed by the NASD to complete this portion of Form R31.

⁴³ No covered round turn transactions would be reported in Part II because all transactions in security futures are reported to a designated clearing agency (OCC) and, thus, should be reported in Part I.

the definition of “covered sale”—in Part II.⁴⁴ Ex-clearing trades are, by definition, not reported to a designated clearing agency and thus would not be captured in the Part I data. However, these trades should be captured by an exchange’s trade reporting system and the aggregate dollar amount of such trades would be reported in Part II.

In addition, a covered exchange that permits its members to report trades directly to NSCC through a QSR would be required to report in Part II the aggregate dollar amount of any such trades that constitute covered sales.⁴⁵ The Commission does not believe that NSCC itself would be an appropriate source of data for such transactions, because QSRs may report net changes in positions to NSCC rather than each separate transaction. However, these transactions should still be captured by the exchange’s trade reporting system. Therefore, the Commission believes that the data captured by an exchange’s trade reporting system would be the best source of data for these covered sales.⁴⁶

Finally, a covered association (*i.e.*, the NASD) would be required to provide in Part II the aggregate dollar amount of *all* covered sales that it captures in a trade reporting system, regardless of whether the association forwards this data to a designated clearing agency. This approach differs from that being proposed for the covered exchanges. In most cases, OTC covered sales are reported to NSCC by the NASD itself (through ACT), just as most exchanges forward their trade data to a designated clearing agency. However, a significant number of OTC covered sales are reported to NSCC directly by QSRs. The Commission could propose that the NASD, like the covered exchanges, be required to report in Part I data on covered sales that it forwards to NSCC for clearance and settlement and report

⁴⁴ Question 9 of proposed Form R31 would require a covered exchange to provide the aggregate dollar amount of covered sales that: (1) Occurred on the exchange; (2) had a charge date in the month of the report; (3) the exchange captured in a trade reporting system; and (4) were ex-clearing transactions.

⁴⁵ Question 8 of proposed Form R31 would require a covered exchange to provide the aggregate dollar amount of covered sales that: (1) Occurred on the exchange; (2) had a charge date in the month of the report; (3) the exchange captured in a trade reporting system; and (4) were reported to a designated clearing agency by a QSR.

⁴⁶ At the time this proposal was issued, NSX was the only exchange that permitted QSRs to report exchange transactions to NSCC. Although QSR trades currently constitute the majority of NSX’s volume, this volume results from the trading activity of only two NSX members. Consequently, at this time, the Commission believes that it would be appropriate to require NSX to report in Part I data, provided by a designated clearing agency, on all of its non-QSR covered sales.

in Part II the data on the covered sales that it captures in a trade reporting system but does not itself report to NSCC. However, the Commission believes that this approach would be difficult for the NASD’s systems to accommodate and would significantly increase the possibility of data being miscounted. Therefore, the Commission is proposing instead that the NASD provide in Part II data on all of the covered sales that it captures in its trade reporting systems, even though the NASD itself forwards most of its transactions to NSCC for clearance and settlement.

Paragraph (a)(4) of proposed Rule 31 would provide that, for any covered sale included in the data reported in Part II, the charge date would be the trade date. The trade date is one of the most important pieces of information captured by a trade reporting system. By contrast, a trade reporting system is likely to have little if any information about the settlement of transactions that are reported to it. Therefore, the Commission believes that the charge date for these covered sales should be the trade date.

c. Part III

Part III would require every covered SRO to provide the aggregate dollar amount of covered sales that: (1) Occurred on the exchange (or, in the case of a covered association, by or through any member of the association otherwise than on a national securities exchange); (2) have a charge date in the month of the report; and (3) it neither reported to a designated clearing agency nor captured in a trade reporting system. For example, some OTC odd-lot transactions are not reported to ACT.⁴⁷ In addition, sales of securities resulting from the exercise of a non-exchange-listed option are not captured by ACT or any other SRO’s trade reporting system. As the NASD’s trade reporting systems have no record of these transactions, the NASD must rely on its members to “self-report” them under the current arrangements for payment of Section 31 fees.

The Commission believes that self-reporting is currently the only viable method of capturing certain transactions for purposes of calculating Section 31 fees. However, the Commission

⁴⁷ NASD rules require a member to report an odd-lot transaction to ACT only if the transaction is to be compared, locked in, and forwarded to NSCC for clearing. See NASD Rule 6130(a). Most odd-lot transactions are internalized trades (*i.e.*, the NASD member fills the odd-lot order out of its own inventory). If an NASD member internalizes an odd-lot customer order, no NSCC report would be necessary and the member would not have to report the transaction to ACT.

anticipates that the amount of self-reported data on which it would base its fee calculations under proposed Rule 31 would be very small.

Paragraph (a)(4) of proposed Rule 31 would provide that, for any covered sale included in the data reported in Part III, the charge date would be the trade date. Because a trade included in Part III would occur outside the normal trade reporting processes, a covered SRO would have great difficulty in determining the settlement date for such a trade. Therefore, the Commission believes that the only feasible charge date for these covered sales would be the trade date, as self-reported by SRO members.

d. Reporting for Months With a Fee Rate Change

For those months in which the Commission is required to adjust the Section 31 fee rate, proposed Form R31 would require covered SROs to report the aggregate dollar amount of covered sales in two parts.⁴⁸ The first part would consist of the aggregate dollar amount of covered sales having a charge date in that month before the date of the fee rate adjustment; the second part would consist of the aggregate dollar amount of covered sales having a charge date in the month on or after the date of the fee rate adjustment.⁴⁹ Separate reporting would be necessary because the Commission would have to multiply the different dollar amounts by the different fee rates to determine the correct total of Section 31 fees owed by each covered SRO.

4. Exempt Sales and Transactions

Not every sale of a security is subject to Section 31 fees, and not every transaction in a security future is subject to Section 31 assessments. The statute itself exempts certain sales and round turn transactions, and the Commission has exempted others pursuant to the authority granted to it by paragraph (f) of Section 31.⁵⁰ Paragraph (a)(11) of proposed Rule 31 would set forth a comprehensive list of all sales of securities (other than security futures) that are exempt from Section 31 fees ("exempt sales"). These provisions would not grant new exemptions from

Section 31 for any types of securities sales but merely would consolidate the existing exemptions.

Paragraphs (a)(11)(i) to (v) would restate exemptions set forth in paragraphs (a) to (e) of existing Rule 31-1.⁵¹ Paragraph (a)(11)(vi), for any sale of an option on security index (including both a narrow-based security index and a non-narrow-based security index), would combine an exemption granted by statute (for a sale of an option on a non-narrow-based security index) with an exemption granted by rule (for a sale of an option on a narrow-based security index).⁵² The net result is that the sale of an option on any security index—be it narrow-based or non-narrow-based—is exempt from Section 31 fees. Paragraph (a)(11)(vi) of proposed Rule 31 would clarify this point. Paragraph (a)(11)(vii) would incorporate language from the statute that specifically exempts sales of bonds, debentures, and other evidences of indebtedness.

Currently, one type of security future transaction is exempt from assessments under Section 31: A round turn transaction in a future on a narrow-based security index.⁵³ This exemption would be incorporated directly into the definition of "covered round turn transaction" in paragraph (a)(7) of proposed Rule 31.

5. Obtaining Data From the Designated Clearing Agencies

Although the duty to submit proposed Form R31 would lie with the covered SROs, paragraph (b)(4) of proposed Rule 31 also would impose a duty on each designated clearing agency to provide a covered SRO, upon request, with the data in the possession of the designated clearing agency needed by the covered SRO to complete Part I of proposed Form R31.

Paragraph (b)(5) of proposed Rule 31 would provide that a covered SRO shall provide in Part I of Form R31 only the data supplied to it by a designated clearing agency. If a covered SRO were to submit its own data in Part I of the form rather than the data supplied by a designated clearing agency, the covered SRO would be in violation of proposed Rule 31. If a covered SRO did not submit its Form R31 in a timely manner but the delay was caused by a designated clearing agency, the designated clearing agency, rather than the covered SRO, would be in violation of proposed Rule 31.

Because the data of the designated clearing agencies may include exempt sales, the Commission would expect the covered SROs and the designated clearing agencies to collaborate in establishing procedures to filter out such sales before the data are reported on Form R31.⁵⁴ The Commission also anticipates that, to fulfill its obligations under paragraph (b)(4) of proposed Rule 31, the designated clearing agencies would have to ensure that reversals are handled properly to avoid double-counting of the same sale, ensure that covered sales that result in no net change of position in any NSCC account are still tabulated, and present the data to the covered SROs in a manner that can easily be reported on proposed Form R31. The Commission's Office of Compliance Inspections and Examinations would periodically review the Section 31 fee process, including the procedures of the covered SROs and the designated clearing agencies.

E. Calculation and Billing of Section 31 Fees

Under paragraph (c)(1) of proposed Rule 31, the amount due from a covered SRO for a billing period, as reflected in its "Section 31 bill,"⁵⁵ would be the sum of the monthly amounts due for each month in the billing period. Each covered SRO would be required to provide on its monthly Form R31 the aggregate dollar amount of covered sales for the month as well as the total number of covered round turn transactions for the month. The Commission would multiply the former number by the "fee rate" (as defined in paragraph (a)(12) of proposed Rule 31)⁵⁶ and the latter number by the

⁵⁴ OCC and the NASD already perform this filtering function under the current arrangements for the calculation and payment of Section 31 fees. For example, OCC has procedures to prevent sales of options on security indexes from being included in the calculation of Section 31 fees. The NASD has procedures to prevent members from being charged for various transactions that are reported to ACT but not subject to Section 31 fees (e.g., sales of foreign securities that are neither registered on a national securities exchange nor subject to last sale reporting pursuant to the rules of the Commission or a registered national securities association). Under the proposed rule, NSCC would have to develop procedures to filter exempt sales out of the data provided to the covered exchanges.

⁵⁵ Paragraph (a)(16) of proposed Rule 31 would define "Section 31 bill" to mean the bill showing the total amount due from a covered SRO for a billing period, as calculated by the Commission based on the data submitted by the covered SRO on its Form R31 submissions for the months of the billing period.

⁵⁶ "Fee rate" would mean the fee rate applicable to covered sales under paragraphs (b) and (c) of Section 31 of the Exchange Act, as adjusted from time to time by the Commission pursuant to paragraph (j) of Section 31.

⁴⁸ See Section 31(j) of the Exchange Act, 15 U.S.C. 78ee(j). The Commission is not required to adjust the assessment charge on transactions in security futures, so covered SROs would be required to report only a single number for the total of such transactions on each monthly form.

⁴⁹ For example, if the fee rate changes on October 16, a covered SRO would be required to report on proposed Form R31 the aggregate dollar amount of its covered sales having a charge date from October 1 to 15 and separately from October 16 to 31.

⁵⁰ 15 U.S.C. 78ee(f).

⁵¹ 17 CFR 240.31-1(a)-(e).

⁵² See Securities Exchange Act Release No. 45371 (January 31, 2002), 67 FR 5199 (February 5, 2002).

⁵³ See 17 CFR 240.31-1(g).

“assessment charge” (as defined in paragraph (a)(1) of proposed Rule 31).⁵⁷ This would yield an amount due from each covered SRO for each month.⁵⁸ The Commission would add the monthly amounts due to obtain the total amount due from the covered SRO for the billing period.

Paragraph (c)(3) of proposed Rule 31 would require each covered SRO to pay by the due date the entire amount due for the billing period, as reflected in its Section 31 bill. An SRO that paid an amount different from that stipulated in its Section 31 bill would be in violation of proposed Rule 31.⁵⁹

F. Special Provisions Relating to Initial Implementation

Whether or not the Commission adopts this proposal, national securities exchanges and national securities associations have an obligation to pay fees and assessments pursuant to Section 31 of the Exchange Act. This obligation for fiscal year 2004 began on September 1, 2003, and the initial billing period concluded on December 31, 2003. The due date for Section 31 fees incurred in that period is March 15, 2004. The second billing period began on January 1, 2004, and will continue until August 31, 2004.

If the Commission adopts this proposal, it would determine the amount of fees and assessments owed by the covered SROs using the new procedure described above for the entire fiscal year 2004 (*i.e.*, for covered sales and covered round turn transactions having a charge date between September 1, 2003, and August 31, 2004, inclusive). The Commission believes that this approach is more reliable and would be consistent with its obligations under the Accountability Act. To accomplish this, however, the

Commission would have to adopt an additional rule to cover the months in fiscal year 2004 prior to the month that proposed Rule 31 would become effective. For example, if Rule 31 were to become effective in March 2004, the first Form R31 would be due from the covered SROs on the tenth business day of April 2004 (covering March 2004). The Commission would still need a mechanism to obtain data on all covered sales and covered round turn transactions with charge dates from September 1, 2003, to February 29, 2004, inclusive.

Therefore, the Commission is also proposing temporary Rule 31T. Rule 31T would require every covered SRO, within one month of the effective date of proposed Rule 31, to submit to the Commission a Form R31 for each month from September 2003 to the month immediately before the initial month for which Rule 31 would require the SRO to submit a Form R31. For example, if Rule 31 were to become effective in March 2004, temporary Rule 31T would require a covered SRO to make Form R31 submissions for each of the months from September 2003 to February 2004, inclusive. Rule 31 itself would require Form R31 submissions for March 2004 and every month thereafter.

III. Solicitation of Comments

The Commission requests comment on all aspects of the proposal. In particular:

1. Are data of the designated clearing agencies an appropriate source for the aggregate dollar amount of covered sales and the total number of covered round turn transactions occurring on the covered exchanges? If not, is there a more appropriate source for this data?

2. Do the exchanges report to a designated clearing agency every transaction that occurs on the exchange, even if the transaction does not result in a net change of position in any participant account of the clearing agency? Do the clearing agencies have the means to be able to tabulate these transactions? If not, what would be an appropriate means to ensure that these transactions are counted by the Commission under proposed Rule 31?

3. Are there any trades (except for trades reported to a designated clearing agency by a QSR) occurring on a national securities exchange that are reported to a clearing agency on a net basis rather than on a transaction-by-transaction basis? If so, would clearing data still be an appropriate basis for the Commission's calculation of Section 31 fees? If not, what source would be more appropriate?

4. Would data from the consolidated tape or an SRO's trade reporting system be a more feasible or reliable source of all of a covered exchange's covered sales? If so, why? Are there sufficient incentives for market participants to correct data that were incorrectly reported to the consolidated tape?

5. Are ACT and TRACS an appropriate source of data for the aggregate dollar amount of covered OTC sales of equity securities? Should proposed Rule 31 and Form R31 allow the NASD to report all covered sales reported to ACT and TRACS in Part II of proposed Form R31? Would the Commission obtain more accurate information by requiring the NASD to report in Part I all covered sales that the NASD itself reports to NSCC and the remainder in Part II?

6. Should the NASD be required to report and pay Section 31 fees on sales of securities resulting from exercises of physical delivery exchange-traded options? If not, which covered SRO should have that duty? Why?

7. Aside from ex-clearing transactions, are there any types of covered sales occurring on a covered exchange that are not reported to a designated clearing agency? If so, what are they and how frequently do they occur? How could the Commission obtain accurate data about them?

8. Is it appropriate to require the covered SROs to submit data on all of their covered sales even though proposed Rule 31 would require them to obtain data on the majority of those sales from one or more designated clearing agencies? Should the Commission obtain this data directly from the designated clearing agencies?

9. Is it appropriate to require covered exchanges to provide data from their trade reporting systems for trades that are reported by a QSR to NSCC? If not, what would be an appropriate source?

10. The Commission has been informed that the number of ex-clearing trades on the exchanges is extremely small. Is this understanding correct? Would it be appropriate for proposed Rule 31 and Form R31 to include a *de minimis* exception, such that a covered exchange would not have to tabulate and report the aggregate dollar amount of such covered sales provided that the exchange certified that the dollar amount was below a certain threshold? If so, what should that threshold be? What amount of Section 31 fees would the Commission be foregoing if the *de minimis* threshold were established at that level?

11. Is ten business days a reasonable time period to give covered SROs to

⁵⁷ “Assessment charge” would mean the amount owed by a covered SRO for each covered round turn transaction pursuant to paragraph (d) of Section 31.

⁵⁸ The Commission believes that it is appropriate to recognize and record on its financial statement accounts receivable for Section 31 fees on a monthly basis. Generally accepted accounting principles require federal government agencies to follow accrual-based accounting. One principle of accrual-based accounting is that an entity must recognize and match revenue and expenses in the same period that those revenues are earned and expenses are incurred. By contrast, in cash-based accounting, revenues are based on amounts collected during a specific period regardless of when the revenues were earned.

⁵⁹ The Commission also believes that a covered SRO, in order to satisfy proposed Rule 31, itself must pay the Section 31 bill in a single payment. Paragraph (c)(3) of proposed Rule 31 would not permit a covered SRO to request a designated clearing agency to pay all or part of its Section 31 bill on its behalf. The Commission believes that the proposed rule would be more difficult to administer if it had to track multiple payments made by or on behalf of each covered SRO.

prepare and submit Form R31? If not, what is a reasonable period of time?

12. Are the charge dates proposed by the Commission appropriate? If not, how should the charge dates be determined?

13. Are there additional means to reduce Commission reliance on data self-reported by SRO members?

14. Should the Commission allow covered SROs to request a designated clearing agency to pay Section 31 bills on their behalf? Why or why not?

IV. Consideration of the Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act⁶⁰ requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act⁶¹ requires the Commission, when promulgating rules under the Exchange Act, to consider the impact any such rules would have on competition. Section 23(a)(2) further provides that the Commission may not adopt a rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission preliminarily believes that proposed Rules 31 and 31T and Form R31 would not have any adverse effect on efficiency, competition, or capital formation. The duty imposed on covered SROs to pay Section 31 fees does not arise from Commission rulemaking, but from the Exchange Act itself. The Commission's proposal would establish a process for calculating and collecting Section 31 fees. The Commission preliminarily believes that proposed Rule 31 would promote efficiency, competition, and capital formation by establishing a transparent process whereby the Commission would calculate and collect Section 31 fees.

The Commission further believes that the proposal would promote efficiency, competition, and capital formation by making more accurate the fee rate adjustments made by the Commission pursuant to paragraph (j) of Section 31.⁶² For example, paragraph (j)(2) requires the Commission to adjust the fee rate if it estimates—by March 1 of the fiscal year, based on the actual

aggregate dollar volume of sales during the first five months of the fiscal year—that the amount that it would collect using the base fee rate set forth in paragraphs (b) and (c) of Section 31⁶³ is “reasonably likely” to be 10% more or less than the “target offsetting collection amount” stipulated in paragraph (I) of the Exchange Act.⁶⁴ The data received on proposed Form R31 should provide the Commission with more complete and more precise data on which to base these estimates.

Commenters are invited to present their views on the proposal's effect on efficiency, competition, and capital formation. Empirical data and other factual support for these views should be provided, if possible.

V. Paperwork Reduction Act

This proposal contains “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”). Accordingly, the Commission has submitted this proposed rulemaking to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.⁶⁵ The titles of the collections of information are “Rule 31, Section 31 Transaction Fees”; “Rule 31T, Temporary Rule Regarding Fiscal Year 2004”; and “Form R31, Form for Reporting Covered Sales and Covered Round Turn Transactions Under Section 31 of the Exchange Act.”

A. Summary of Collection of Information

Proposed Rules 31 and 31T and Form R31 would require covered SROs to provide the Commission data on all of their covered sales and covered round turn transactions. The proposed form, due on a monthly basis, would consist of three parts. Part I would require each covered exchange to provide the aggregate dollar amount of the covered sales with a charge date in the month of the report that it reported to a designated clearing agency. Part I also would require each covered exchange to provide the total number of covered

round turn transactions in security futures having a charge date in the month of the report that it reported to a designated clearing agency. Finally, Part I would require a covered association to provide the aggregate dollar amount of covered sales that: (1) occurred by or through any member of the association; (2) had a charge date in the month of the report; and (3) resulted from the exercise of a physical delivery exchange-traded option. Paragraph (b)(4) of proposed Rule 31 would require the designated clearing agencies to provide the covered SROs, upon request, with the data in their possession needed by the covered SROs to complete proposed Form R31.

Part II would require each covered exchange to provide the aggregate dollar amount of the covered sales having a charge date in that month that it captures in a trade comparison system but does not report to a designated clearing agency. Separate entries would be required for covered sales that: (1) were reported to a designated clearing agency by a QSR; and (2) were exchanging transactions. Part II also would require a covered association to provide the aggregate dollar amount of any covered sales that: (1) occurred by or through any member of the association; (2) had a charge date in the month of the report; and (3) that it captures in a trade comparison system—regardless of whether it reported some of those transactions to a designated clearing agency.

Part III would require each covered SRO to provide the aggregate dollar amount of the covered sales that: (1) occurred on the exchange (or, in the case of a covered association, by or through any member of the association otherwise than on a national securities exchange); (2) had a charge date in that month; and (3) it neither captured in a trade comparison system nor reported to a designated clearing agency.

For any month in which the Commission is required to adjust the Section 31 fee rate, a covered SRO would have to separate the data on the aggregate dollar amount of covered sales into two parts. The first part would consist of the aggregate dollar amount of covered sales having a charge date in that month before the date of the fee rate adjustment; the second part would consist of the aggregate dollar amount of covered sales having a charge date on or after the date of the fee rate adjustment.

B. Proposed Use of Information

The Commission would use the information obtained on proposed Form R31 to calculate the fees and assessments owed by each covered SRO

⁶⁰ 15 U.S.C. 78c(f).

⁶¹ 15 U.S.C. 78w(a)(2).

⁶² 15 U.S.C. 78ee(j).

⁶³ 15 U.S.C. 78ee(b) and (c).

⁶⁴ 15 U.S.C. 78ee(I). Paragraph (j)(1) of Section 31 also requires the Commission to adjust the fee rate “to a uniform adjusted rate that, when applied to the baseline estimate of the aggregate dollar amount of sales for such fiscal year, is reasonably likely to produce aggregate fee collections under [Section 31] (including assessments collected under subsection (d)) that are equal to the target offsetting collection amount for such fiscal year.” 15 U.S.C. 78ee(j)(1).

⁶⁵ 44 U.S.C. 3501 *et seq.*

to the Commission pursuant to Section 31 of the Exchange Act. Although such fees and assessments are due only twice a year (on March 15 and September 30), the Commission would use this data to calculate and record a receivable on its financial statements every month.

C. Respondents

There are currently 12 covered SROs that would be subject to the collection of information requirements of this proposal. In addition, there are currently two entities—NSCC and OCC—that would be designated clearing agencies required by paragraph (b)(4) of proposed Rule 31 to provide the covered SROs with the data in their possession needed by the covered SROs to complete Part I of proposed Form R31. Therefore, there would be 14 respondents in total.

D. Total Annual Reporting and Recordkeeping Burden

1. Development Burden for System Modifications

Under proposed Rule 31, each covered SRO would have a duty to provide on proposed Form R31 the aggregate dollar amount of all of its covered sales and the total number of its covered round turn transactions having a charge date in the month of the report. To comply with this collection of information requirement, the covered SROs would incur one-time burdens to develop new systems capabilities and procedures to collect and tabulate the necessary data. The designated clearing agencies also would incur burdens in configuring their systems to enable them to meet their obligations under paragraph (b)(4) of proposed Rule 31.

a. Options and Security Futures

Currently, the options exchanges and security futures exchanges have arrangements with OCC whereby OCC calculates, collects, and pays all of the Section 31 fees and assessments on behalf of the exchanges. OCC already has procedures, therefore, to prevent exempt sales from being included in the calculation of Section 31 fees. However, OCC makes payments to the Commission in one lump-sum on behalf of these seven exchanges without stipulating the amount being paid on behalf of each exchange. Under proposed Rule 31, OCC would have to provide each options exchange with the aggregate dollar amount of its covered sales in options and each security futures exchange with the total number of its covered round turn transactions in security futures. Therefore, OCC would need to develop procedures to allocate

each covered sale or covered round turn transaction to a specific exchange. Based on conversations between Commission staff and OCC, the Commission preliminarily estimates this development time to be 180 staff hours.

In light of the fact that all covered sales in options and covered round turn transactions in security futures are cleared and settled by OCC, and that OCC would bear the primary burden for making systems changes to accommodate the proposal, the Commission preliminarily believes that the initial development burden on the five options exchanges and two security futures exchanges would be minimal. The Commission preliminarily estimates that the total initial burden on these seven exchanges would be 10 staff hours per exchange for a total of 70 hours (7 exchanges \times 10 hours/exchange). Thus, the Commission preliminarily concludes that OCC, the options exchanges, and the security futures exchanges together would incur burdens for initial development of new systems and processes of 250 staff hours (180 + 70).

b. Exchange-Traded Equities

NSCC does not currently perform any functions with respect to Section 31. Therefore, NSCC is likely to incur more initial development burdens than OCC. To provide the data to the covered SROs required by the proposal, NSCC would need to configure its systems to accurately tabulate the aggregate dollar amount of covered sales forwarded to it by the equities exchanges. Such configuration would include, among other things, handling reversals appropriately to avoid double-counting of the same transaction, designing a method to filter exempt sales out of the clearing data, ensuring that covered sales that result in no net change of position in any NSCC account are still tabulated, and presenting the data to the covered SROs in a manner that can be easily reported on proposed Form R31.

Based on conversations between Commission staff and the proposed respondents, the Commission preliminarily estimates that NSCC and the eight exchanges that trade equities would collectively incur an aggregate burden of 1000 staff hours to develop new systems and processes to fulfill their obligations under proposed Rule 31.

c. OTC Equities

The NASD would be the only covered association that would be required to report on proposed Form R31 covered sales occurring otherwise than on a national securities exchange. Under the

current arrangements for the payment of Section 31 fees, the NASD calculates the aggregate dollar amount of sales reported to ACT after filtering out sales that are exempt from Section 31 fees. The NASD also administers a paper-based system whereby NASD members report and pay fees on odd-lot sales as well as sales of securities resulting from the exercise of non-exchange-listed options, neither of which are reported to ACT. The Commission anticipates that these NASD procedures would continue unchanged under the proposal. In addition, however, the proposal would require the NASD to tabulate and report all of the covered sales occurring in the ADF, although TRACS, the trade reporting system for the ADF, currently is not configured to provide such data. Finally, the proposal would require the NASD for the first time to report and pay Section 31 fees on covered sales resulting from exercises of physical delivery exchange-traded options.

Based on conversations between Commission staff and the NASD, the Commission preliminarily estimates that the necessary configurations to TRACS would require 50 hours of NASD staff time. In addition, the Commission preliminarily believes it would require 25 hours of OCC and NASD staff time to develop a process whereby OCC would convey, and the NASD would receive and report on its Form R31, data on covered sales resulting from exercises of physical delivery exchange-traded options. This burden estimate does not include any time spent by OCC in compiling this data, because OCC already does so in levying and paying to the Commission Section 31 fees on behalf of the options exchanges collectively. Thus, the estimate of 25 burden hours includes only the burden of developing a process for conveying that data in a regular and reliable manner to the NASD. Finally, in light of the NASD's existing processes to pass Section 31 fees to its members based on transaction volume (as reflected in ACT) and to collect data on sales of certain securities self-reported by its members, the Commission preliminarily estimates that it would require only 15 staff hours to adapt to these processes to the requirements of the proposal.

In sum, the Commission preliminarily estimates that the initial development burden on the NASD and OCC to comply with the proposal would be 80 staff hours (50 + 25 + 15).

d. Total Development Burden

In sum, the Commission preliminarily believes that the 14 respondents to the proposed collection of information

would incur a total one-time development burden of 1330 staff hours (250 hours for OCC and the options and security futures exchanges + 1000 for NSCC and the equities exchanges + 80 for the NASD and OCC).

2. Ongoing Compliance Burden

On an ongoing basis, covered SROs would be required to submit to the Commission proposed Form R31 within ten business days after the end of every month. Proposed Rule 31 would require a designated clearing agencies to furnish to the covered SROs the data in its possession needed by the SROs to complete Part I of proposed Form R31.

a. Designated Clearing Agencies

Presently, NSCC clears transactions occurring on eight national securities exchanges and OCC clears transactions occurring on seven exchanges.⁶⁶ Equities trading volume is far larger than options trading volume. Therefore, the Commission believes that NSCC's monthly burden in tabulating the necessary data and providing it to the exchanges would be larger than OCC's burden. Based on conversations between Commission staff, NSCC, and OCC, the Commission preliminarily estimates that NSCC would incur an average monthly burden of 4 staff hours and OCC an average monthly burden of 2 staff hours to provide the exchanges with the data for Part I of proposed Form R31. In addition, the Commission preliminarily estimates that, once the initial processes have been developed, OCC would incur an additional monthly burden of 1 staff hour to provide the NASD with the aggregate dollar amount of covered sales resulting from exercises of physical delivery exchange-traded options.

In addition, the Commission anticipates that proposed Rule 31 would impose additional financial resource burdens on NSCC. These resources would be needed to provide, among other things, CPU time, data storage, power, and systems maintenance. Based on conversations between Commission staff and NSCC, the Commission preliminarily estimates that this burden would be \$1000 per month.

b. Covered Exchanges

The covered exchanges themselves also would incur burdens in fulfilling

⁶⁶ Currently, four exchanges—BSE, CHX, NSX, and NYSE—trade only equity securities, which are cleared and settled by NSCC. Three exchanges—ISE, NQLX, and OneChicago—trade securities that are cleared and settled only by OCC. Four exchanges—Amex, CBOE, PCX, and PHLX—trade both equities and options, thus requiring the clearance and settlement services of both NSCC and OCC.

the requirement imposed by paragraph (b) of proposed Rule 31 to complete and submit to the Commission proposed Form R31 on a monthly basis. The Commission believes that an exchange's burden would increase slightly if it trades both equities and options, since the exchange would have to coordinate inputs from both NSCC and OCC. Furthermore, the Commission believes that an exchange that trades only options or security futures would incur slightly less burden than an exchange that trades only equities, because all data on covered sales of options should be obtainable from OCC and reported in Part I of proposed Form R31. By contrast, a covered exchange that trades equities is more likely to have covered sales for which it would have to rely on sources other than a designated clearing agency and that must be reported in Parts II or III. Thus, the Commission preliminarily estimates that the ongoing monthly burden for the covered exchanges to complete and submit to the Commission proposed Form R31 would be as follows:

- two exchanges that trade only security futures and one exchange that trades only options: 0.5 hours/form
- four exchanges that trade only equities: 1.0 hours/form
- four exchanges that trade both equities and options: 1.5 hours/form

Thus, the Commission preliminarily concludes that covered exchanges would incur a total of 11.5 burden hours—(3 OCC-only exchanges × 0.5 hour/exchange = 1.5 hours) + (4 NSCC-only exchanges × 1.0 hour/exchange = 4.0 hours) + (4 dual exchanges × 1.5 hours/exchange = 6 hours)—to complete the Form R31 submissions required in a given month.

c. Covered Associations

The Commission preliminarily estimates that one covered association, the NASD, would incur a monthly burden of 1 staff hour to receive, confirm, and report in Part I of proposed Form R31 the data provided to it by OCC on the aggregate dollar amount of covered sales having a charge date in the month of the report resulting from exercises of physical delivery exchange-traded options. Furthermore, the Commission preliminarily estimates that 2 NASD staff hours would be required to produce monthly reports from ACT and TRACS of all covered sales having a charge date in that month and to record those data on proposed Form R31. Finally, the Commission preliminarily estimates that 1 NASD staff hour would be required to aggregate and record in Part III of proposed Form R31 data on covered

sales that are self-reported by NASD members. The Commission preliminarily concludes that the monthly burden imposed on the NASD by proposal would be 4 staff hours (1 + 2 + 1).

d. Total Ongoing Monthly Burden

In summary, the Commission preliminarily believes that the total burden on the 14 respondents for completing Form R31 for a single month would be 22.5 staff hours (7 hours for two designated clearing agencies + 11.5 hours for 11 covered exchanges + 4 hours for one covered association), or 270 staff hours per year (22.5 hours/month × 12 months). In addition, the Commission preliminarily believes that one designated clearing agency, NSCC, would incur additional financial burdens of \$1000 per month or \$12,000 per year.

3. Proposed Rule 31T

Proposed temporary Rule 31T would require every covered SRO, within one month of the effective date of proposed Rule 31, to submit to the Commission a Form R31 for each of the months September 2003 to the month that Rule 31 becomes effective. This would enable the Commission to obtain data on all covered sales and covered round turn transactions occurring in fiscal year 2004, regardless of the effective date of proposed Rule 31. The Commission notes that national securities exchanges and national securities associations have a duty to pay fees and assessments pursuant to Section 31 regardless of whether the Commission adopts this proposal.

The Commission preliminarily estimates that, if the proposal is adopted, temporary Rule 31T would require each covered SRO to provide six additional Form R31 submissions. In Section V(D)(2)(d) above, the Commission estimated that the total burden on the 14 respondents to complete one month's worth of Form R31 submissions would be 22.5 staff hours. Therefore, the Commission estimates that proposed Rule 31T would impose a total burden of 135 staff hours (6 forms × 22.5 hours/form) on the 14 respondents.

E. Request for Comments

The Commission requests comment in order to:

- evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information has practical utility;

- evaluate the accuracy of the Commission's estimates of the burden of the proposed collection of information;
- determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;

- evaluate whether there are ways to minimize the burden of the collection of information on the respondents, including through the use of automated collection techniques or other forms of information technology; and

- evaluate whether the proposed amendments would have any effect on any other collection of information not previously identified in this section.

Any member of the public may direct to the Commission any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB; Attention: Desk Officer for the Securities and Exchange Commission; Office of Information and Regulatory Affairs; Washington, DC 20503; and send a copy of the comments to Jonathan G. Katz; Secretary; Securities and Exchange Commission; 450 Fifth Street, NW.; Washington, DC 20549-0609, with reference to File No. S7-05-04. Requests for materials submitted to the OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-05-04, and be submitted to the Securities and Exchange Commission; Records Management; Office of Filings and Information Services; 450 Fifth Street, NW.; Washington, DC 20549. Because the OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication of this notice.

VI. Consideration of Costs and Benefits

The Commission is considering the costs and benefits of proposed Rules 31 and 31T and Form R31, as described below. The Commission encourages comments that address this analysis, as well as additional costs or benefits that we may not have considered. Empirical data and other factual support should be provided, if possible.

A. Costs

Proposed Rule 31 and Form R31 would require covered SROs to provide the Commission on a monthly basis data on their covered sales and covered round turn transactions. Proposed

temporary Rule 31T would require covered SROs to provide the Commission with Form R31 submissions for the months of September 2003 until the month that Rule 31 becomes effective. As discussed above in Section V, the proposal would cause the covered SROs and designated clearing agencies to incur certain paperwork costs in tabulating and reporting to the Commission the data required by Form R31. The Commission preliminarily estimates that the covered SROs and designated clearing agencies would incur a burden of 1330 staff hours of initial development costs, 270 staff hours per year to submit proposed Form R31 on a monthly basis, and 135 staff hours to comply with proposed temporary Rule 31T. The Commission also preliminarily estimates that one designated clearing agency, NSCC, would incur a monthly financial cost of \$1000 for systems maintenance to comply with proposed Rule 31.

In addition, the Commission believes that certain covered SROs may incur additional costs to develop new methods for allocating Section 31 fees among their members if the Commission adopts proposed Rule 31. Currently, the covered SROs generate the funds to pay Section 31 fees to the Commission by passing these fees on to their members. The NYSE and Amex require their members to self-report the aggregate dollar amount of their sales of securities and the corresponding Section 31 fees due based on that amount. Every other equities exchanges imposes fees on their members based on the sales of securities that the exchange reports to the consolidated tape. If the Commission adopts a rule that would base the calculation of Section 31 fees largely on clearing data, either or both of the existing methods for allocating Section 31 fees among members of the equities exchanges could yield an amount that differs from that calculated by the Commission pursuant to proposed Rule 31.

Therefore, a covered exchange might wish to develop new procedures to subdivide Section 31 fees among its members if the proposal is adopted. Paragraph (b)(4) of proposed Rule 31 would require a designated clearing agency to provide covered SROs, upon request, with the data in its possession needed by the SROs to complete Part I of Form R31. A covered SRO could also request that the designated clearing agency subdivide the data by SRO member so that the SRO could impose fees on each member for these covered sales or covered round turn transactions. While subdividing the data in this manner would not be required by

proposed Rule 31, the Commission anticipates that covered SROs may elect to establish such processes so that they collect from their members only the precise amount that the Commission bills them under proposed Rule 31. A covered SRO that wishes to establish a new procedure for dividing its Section 31 fees among its members might be required to propose a rule change pursuant to Section 19(b) of the Exchange Act⁶⁷ in order to do so.⁶⁸

The Commission notes that this proposal would not impose new costs on covered SROs in the form of higher Section 31 fees. The rate at which an SRO incurs liability to the Commission for covered sales and covered round turn transactions is set by the statute; the proposal would merely establish a procedure for the Commission to obtain a reliable measure of the aggregate dollar amount of covered sales and the total number of covered round turn transactions and, using that information, to calculate the appropriate amount of fees and assessments due from each covered SRO pursuant to Section 31.

B. Benefits

A primary benefit of this proposal is that the means by which the Commission derives a large source of its revenue would become more transparent and more easily subject to verification. The Commission believes that the proposal would allow it to obtain the most complete and reliable data available on the aggregate dollar amount of covered sales and total number of covered round turn transactions occurring in the U.S. securities markets. This data would be provided on a simple and easy-to-use form. The Commission believes that requiring the data to be reported in this manner would greatly facilitate an auditor's understanding of the source and calculation of the Section 31 fee receivables on the Commission's financial statements. The Commission further believes that the public interest benefits when the Commission can demonstrate that it is collecting the correct amount of Section 31 fees and properly carrying out the fiscal responsibilities assigned to it by Congress.

A related benefit of this proposal is that the fee rate adjustments made by

⁶⁷ 15 U.S.C. 78s(b).

⁶⁸ In considering a proposed rule change submitted by an exchange to create a new method for allocating its Section 31 fees among its members, the Commission would examine the proposal's consistency with Section 6(b) of the Exchange Act, 15 U.S.C. 78f(b), particularly the requirement that dues, fees, and other charges imposed by the exchange be allocated equitably among the exchange's members.

the Commission pursuant to paragraph (j) of Section 31⁶⁹ would be more precise. For example, paragraph (j)(2) requires the Commission to adjust the fee rate if it estimates—by March 1 of the fiscal year, based on the actual aggregate dollar volume of sales during the first five months of the fiscal year—that the amount that it would collect using the base fee rate set forth in paragraphs (b) and (c) of Section 31⁷⁰ is “reasonably likely” to be 10% more or less than the “target offsetting collection amount” stipulated in paragraph (l) of the Exchange Act. The data received on proposed Form R31 should provide the Commission with more complete and more precise data on which to base these estimates.

C. Request for Comments

The Commission requests comments on how any aspect of the proposal would create benefits or impose costs on market participants. In particular:

- Would covered SROs have to propose rule changes to implement new procedures for allocating Section 31 fees among their members? How much would it cost to submit such a filing pursuant to Section 19(b) of the Exchange Act?
- Are there other ways in which the Commission could carry out the Section 31 fee collection process in a manner consistent with generally accepted accounting principles as they apply to federal agencies?
- Are there other costs or benefits to this proposal?
- Do the benefits justify the costs?

VII. Regulatory Flexibility Act

The Commission hereby certifies, pursuant to the Regulatory Flexibility Act (“RFA”),⁷¹ that proposed Rules 31 and 31T and Form R31, if adopted, would not have a significant economic impact on a substantial number of small businesses. Proposed Rule 31 and Form R31 would establish a formal procedure for the calculation and payment of Section 31 fees. Twelve entities—the 11 national securities exchanges and the NASD—would be required to provide the Commission with data on their covered sales and covered round turn transactions. None of these entities is a “small business” for purposes of the RFA.⁷² In addition, two designated

clearing agencies—NSCC and OCC—would be required to provide the covered SROs with the data in their possessions needed by the covered SROs to complete Part I of proposed Form R31. Neither clearing agency is a “small business” for purposes of the RFA.⁷³ No other entities would incur obligations directly from proposed Rules 31 and 31T. Accordingly, the Commission certifies that proposed Rules 31 and 31T and Form R31 would not have a significant economic impact on a substantial number of small businesses.

The Commission requests written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small businesses and provide empirical data to support the extent of the impact.

VIII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,⁷⁴ a rule is “major” if it has resulted or is likely to result in:

- An annual effect on the economy of \$100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

The Commission requests comment on the potential impact of the proposal on the economy on an annual basis. Empirical data and other factual support should be provided, if possible.

IX. Statutory Authority

Proposed Rules 31 and 31T under the Exchange Act would be adopted pursuant to 15 U.S.C. 78a *et seq.*, particularly Sections 6, 15A, 17A, 19, 23(a), and 31 of the Exchange Act (15 U.S.C. 78f, 78o–3, 78q–1, 78s, 78w(a), and 78ee).

(other than a natural person) that is not a small business or small organization as defined in Rule 0–10. The Commission also has found that the NASD is not a small business.

⁶⁹ See 17 CFR 240.0–10(d). Paragraph (d) of Rule 0–10 states that the term “small business,” when used with reference to a clearing agency, means a clearing agency that: (1) compared, cleared, and settled less than \$500 million in securities transactions during the preceding fiscal year (or in the time that it has been in business, if shorter); (2) had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or in the time that it has been in business, if shorter); and (3) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in Rule 0–10.

⁷⁴ Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996).

List of Subjects in 17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II of the Code of Federal Regulations as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Section 240.31–1 is revised to read as follows:

§ 240.31 Section 31 transaction fees.

(a) *Definitions.* For the purpose of this section, the following definitions shall apply:

(1) *Assessment charge* means the amount owed by a covered SRO for a covered round turn transaction pursuant to section 31(d) of the Act (15 U.S.C. 78ee(d));

(2) *Billing period means*, for a single calendar year:

(i) January 1 to the close of August 31 (“billing period 1”); or

(ii) September 1 to the close of December 31 (“billing period 2”).

(3) *Charge date* means the date on which a covered sale or covered round turn transaction occurs for purposes of determining the liability of a covered SRO pursuant to section 31 of the Act. The charge date is the settlement date with respect to a covered sale or a covered round turn transaction that a covered exchange reports to a designated clearing agency. The charge date is the trade date with respect to a covered sale occurring on a covered exchange that the exchange does not report to a designated clearing agency, and with respect to any covered sale occurring otherwise than on a national securities exchange.

(4) *Covered association* means any national securities association by or through any member of which covered sales or covered round turn transactions occur otherwise than on a national securities exchange.

(5) *Covered exchange* means any national securities exchange on which

⁶⁹ 15 U.S.C. 78ee(j).

⁷⁰ 15 U.S.C. 78ee(b) and (c).

⁷¹ 5 U.S.C. 605(b).

⁷² See 17 CFR 240.0–10(e). Paragraph (e) of Rule 0–10 states that the term “small business,” when referring to an exchange, means any exchange that has been exempted from the reporting requirements of Rule 11Aa3–1 under the Exchange Act, 17 CFR 240.11Aa3–1, and is not affiliated with any person

covered sales or covered round turn transactions occur.

(6) *Covered sale* means a sale of a security, other than an exempt sale or a sale of a security future, occurring on a national securities exchange or by or through any member of a national securities association otherwise than on a national securities exchange.

(7) *Covered round turn transaction* means a round turn transaction in a security future, other than a round turn transaction in a future on a narrow-based security index, occurring on a national securities exchange or by or through a member of a national securities association otherwise than on a national securities exchange.

(8) *Covered SRO* means a covered exchange or covered association.

(9) *Designated clearing agency* means a clearing agency registered under section 17A of the Act (15 U.S.C. 78q-1) that clears and settles covered sales or covered round turn transactions.

(10) *Due date* means:

(i) March 15, with respect to the amounts owed by covered SROs under section 31 of the Act (15 U.S.C. 78ee) for covered sales and covered round turn transactions having a charge date in billing period 2; and

(ii) September 30, with respect to the amounts owed by covered SROs under section 31 of the Act (15 U.S.C. 78ee) for covered sales and covered round turn transactions having a charge date in billing period 1.

(11) *Exempt sale* means:

(i) Any sale of a security offered pursuant to an effective registration statement under the Securities Act of 1933 (except a sale of a put or call option issued by the Options Clearing Corporation) or offered in accordance with an exemption from registration afforded by section 3(a) or 3(b) of the Securities Act of 1933 (15 U.S.C. 77c(a) or 77c(b)), or a rule thereunder;

(ii) Any sale of a security by an issuer not involving any public offering within the meaning of section 4(2) of the Securities Act of 1933 (15 U.S.C. 77d(2));

(iii) Any sale of a security pursuant to and in consummation of a tender or exchange offer;

(iv) Any sale of a security upon the exercise of a warrant or right (except a put or call), or upon the conversion of a convertible security;

(v) Any sale of a security that is executed outside the United States and is not reported, or required to be reported, to a transaction reporting association as defined in § 240.11Aa3-1 and any approved plan filed thereunder;

(vi) Any sale of an option on a security index (including both a narrow-

based security index and a non-narrow-based security index); and

(vii) Any sale of a bond, debenture, or other evidence of indebtedness.

(12) *Fee rate* means the fee rate applicable to covered sales under paragraphs (b) or (c) of section 31 of the Act (15 U.S.C. 78ee(b) or (c)), as adjusted from time to time by the Commission pursuant to paragraph (j) of section 31 of the Act (15 U.S.C. 78ee(j));

(13) *Narrow-based security index* means the same as in section 3(a)(55)(B) and (C) of the Act (15 U.S.C. 78c(a)(55)(B) and (C)).

(14) *Round turn transaction in a security future* means one purchase and one sale of a contract of sale for future delivery.

(15) *Physical delivery exchange-traded option* means a securities option that is listed and registered on a national securities exchange and settled by the physical delivery of the underlying securities.

(16) *Section 31 bill* means the bill sent by the Commission to a covered SRO pursuant to section 31 of the Act (15 U.S.C. 78ee) showing the total amount due from the covered SRO for the billing period, as calculated by the Commission based on the data submitted by the covered SRO in its Form R31 (§ 249.11 of this chapter) submissions for the months of the billing period.

(17) *Trade reporting system* means an automated facility operated by a covered SRO used to collect or compare trade data.

(b) *Reporting of covered sales and covered round turn transactions.* (1) Each covered SRO shall submit Form R31 (§ 249.11 of this chapter) to the Commission within ten business days after the end of each month.

(2) A covered exchange shall provide on Form R31 the following data on covered sales and covered round turn transactions occurring on that exchange that have a charge date in that month:

(i) The aggregate dollar amount of covered sales that it reported to a designated clearing agency, as reflected in the data provided by the designated clearing agency;

(ii) The aggregate dollar amount of covered sales that it captured in a trade reporting system but did not report to a designated clearing agency;

(iii) The aggregate dollar amount of covered sales that it neither captured in a trade reporting system nor reported to a designated clearing agency; and

(iv) The total number of covered round turn transactions that it reported to a designated clearing agency, as reflected in the data provided by the designated clearing agency.

(3) A covered association shall provide on Form R31 the following data on covered sales and covered round turn transactions occurring by or through any member of such association otherwise than on a national securities exchange that have a charge date in that month:

(i) The aggregate dollar amount of covered sales resulting from the exercise of a physical delivery exchange-traded option, as reflected in the data provided by a designated clearing agency;

(ii) The aggregate dollar amount of covered sales that it captured in a trade comparison system;

(iii) The aggregate dollar amount of covered sales that it did not capture in a trade comparison system; and

(iv) The total number of covered round turn transactions that it reported to a designated clearing agency, as reflected in the data provided by the designated clearing agency.

(4) A designated clearing agency shall provide a covered SRO, upon request, the data in its possession needed by the covered SRO to complete Part I of Form R31.

(5) A covered SRO shall provide in Part I of Form R31 only the data supplied to it by a designated clearing agency.

(c) *Calculation and billing of section 31 fees.* (1) The amount due from a covered SRO for a billing period, as reflected in its Section 31 bill, shall be the sum of the monthly amounts due for each month in the billing period.

(2) The monthly amount due from a covered SRO shall equal:

(i) The aggregate dollar amount of its covered sales that have a charge date in that month, times the fee rate; plus

(ii) The total number of its covered round turn transactions that have a charge date in that month, times the assessment charge.

(3) By the due date, each covered SRO shall pay the Commission the entire amount due for the billing period, as reflected in its Section 31 bill.

3. Section 240.31T is added to read as follows:

§ 240.31T Temporary rule regarding fiscal year 2004.

(a) Within one month of the effective date of § 240.31, each covered SRO shall submit to the Commission a completed Form R31 (§ 249.11 of this chapter) for each of the months September 2003 to the month immediately before the month that § 240.31 became effective, inclusive.

(b) This temporary section shall expire [six months after the effective date of § 240.31].

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

5. Section 249.11 and Form R31 (referenced in § 249.11) are added to read as follows:

§ 249.11 Form R31 for reporting covered sales and covered round turn transactions under section 31 of the Act.

This form shall be used by each national securities exchange to report to the Commission within ten business

days after the end of every month the aggregate dollar amount of sales of securities that occurred on the exchange, had a charge date in the month of the report, and are subject to fees pursuant to section 31(b) of the Act (15 U.S.C. 78ee) and § 240.31 of this chapter; and the total number of round turn transactions in security futures that occurred on the exchange, had a charge date in the month of the report, and are subject to assessments pursuant to section 31(d) of the Act and § 240.31 of this chapter. This form also shall be used by a national securities association to report to the Commission within ten business days after the end of every month the aggregate dollar amount of

sales or securities that occurred by or through a member of the association otherwise than on a national securities exchange, had a charge date in the month of the report, and are subject to fees pursuant to section 31(c) of the Act and § 240.31 of this chapter; and the total number of round turn transactions in security futures that occurred by or through any member of the association otherwise than on a national securities exchange, had a charge date in the month of the report, and are subject to assessments pursuant to section 31(d) of the Act and § 240.31 of this chapter.

Note: The text of Form R31 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM R31

OMB APPROVAL

OMB Number: 3235-0000

Expires: xxxx, 2006

Estimated average burden hours per form: 1.6

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM FOR REPORTING COVERED SALES AND COVERED ROUND TURN
TRANSACTIONS UNDER SECTION 31 OF THE
SECURITIES EXCHANGE ACT OF 1934

FORM R31 INSTRUCTIONS

A. EXPLANATION OF TERMS USED IN THIS FORM

CHARGE DATE—The date on which a covered sale or covered round turn transaction occurs for purposes of determining the liability of a covered SRO pursuant to Section 31 of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78ee). The charge date is the settlement date with respect to a covered sale or covered round turn transaction that a covered exchange reports to a designated clearing agency. The charge date is the trade date with respect to a covered sale occurring on a covered exchange that the exchange does not report to a designated clearing agency, and with respect to any covered sale occurring otherwise than on a national securities exchange.

COVERED ASSOCIATION—Any national securities association by or through any member of which covered sales or covered round turn transactions occur otherwise than on a national securities exchange.

COVERED EXCHANGE—Any national securities exchange on which covered sales or covered round turn transactions occur.

COVERED SALE—A sale of a security, other than an exempt sale or a sale of a security future, occurring on a national securities exchange or by or through any member of a national securities association otherwise than on a national securities exchange.

COVERED ROUND TURN TRANSACTION—A round turn transaction in a security future, other than a round turn transaction in a future on a narrow-based security index, occurring on a national securities exchange or by or through a member of a national securities association otherwise than on a national securities exchange.

COVERED SRO—A covered exchange or a covered association.

DESIGNATED CLEARING AGENCY—A clearing agency registered under Section 17A of the Exchange Act (15 U.S.C. 78q-1) that clears and settles covered sales or covered round turn transactions.

EX-CLEARING TRANSACTION—A sale of a security that clears and settles otherwise than through a designated clearing agency.

EXEMPT SALE—(i) Any sale of a security offered pursuant to an effective registration statement under the Securities Act of 1933 ("Securities Act") (except a sale of a put or call option issued by the Options Clearing Corporation) or offered in accordance with an exemption from registration afforded by Section 3(a) or 3(b) thereof (15 U.S.C. 77c(a) or 77c(b)), or a rule thereunder; (ii) any sale of a security by an issuer not involving any public offering within the meaning of Section 4(2) of the Securities Act (15 U.S.C. 77d(2)); (iii) any sale of a security pursuant to and in consummation of a tender or exchange offer; (iv) any sale of a security upon the exercise of a warrant or right (except a put or call), or upon the conversion of a convertible security; (v) any sale of a security that is executed outside the United States and is not reported, or required to be reported, to a transaction reporting association as defined in 17 CFR 240.11Aa3-1 and any approved plan filed thereunder; (vi) any sale of an option on a security index (including both a narrow-based security index and a non-narrow-based security index); and (vii) any sale of a bond, debenture, or other evidence of indebtedness.

FEE RATE—The fee rate applicable to covered sales under paragraphs (b) or (c) of Section 31 of the Exchange Act (15 U.S.C. 78ee(b) and (c)), as adjusted from time to time by the Commission pursuant to paragraph (j) of Section 31 of the Exchange Act (15 U.S.C. 78ee(j)).

NARROW-BASED SECURITY INDEX—Has the same meaning as in Section 3(a)(55)(B) and (C) of the Exchange Act (15 U.S.C. 78c(a)(55)(B) and (C)).

PHYSICAL DELIVERY EXCHANGE-TRADED OPTION—An option that is listed and registered on a national securities exchange and that is settled by the physical delivery of the underlying securities.

QUALIFIED SPECIAL REPRESENTATIVE—A member of a designated clearing agency that operates, has an affiliate that operates, or clears for a broker-dealer that operates, an automated execution system where the designated clearing agency member is on the contra-side of every transaction.

TRADE REPORTING SYSTEM—An automated facility operated by a covered SRO used to collect or compare trade data.

B. GENERAL INSTRUCTIONS

1. Covered exchanges shall use Form R31 to report to the Commission, pursuant to Section 31 of the Securities Exchange Act of 1934 ("Exchange Act") and 17 CFR 240.31, data regarding all covered sales and covered round turn transactions that: (1) occurred on the exchange; and (2) have a charge date in the month for which this form is being submitted.
2. Covered associations shall use Form R31 to report to the Commission, pursuant to Section 31 of the Exchange Act and Rule 31 thereunder, data regarding all covered sales that: (1) occurred by or through any member of the association otherwise than on a national securities exchange; and (2) have a charge date in the month for which this form is being submitted.
3. Form R31 shall be submitted within ten business days after the end of every month, and such other times as stipulated in 17 CFR 240.31T.
4. A covered SRO must obtain the data necessary to complete Part I of this Form R31 from a designated clearing agency. Pursuant to Rule 31, a designated clearing agency is required, upon request, to provide a covered SRO with the data in its possession needed by the covered SRO to complete Form R31. A covered SRO shall provide in Part I of this Form R31 only the data supplied to it by a designated clearing agency.
5. For any item that requests the aggregate dollar amount of covered sales, enter responses "A" and "B" as follows. For any month in which the Commission does not adjust the fee rate, enter the aggregate dollar amount of covered sales for the entire month in "A" and leave "B" blank. For any month in which the Commission adjusts the fee rate, enter in "A" the aggregate dollar amount of covered sales having a charge date in that month before the date of the fee rate adjustment, and enter in "B" the aggregate dollar amount of covered sales having a charge date in that month on or after the date of the fee rate adjustment. The total number of covered round turn transactions should be provided in a single entry.
6. **CONTACT EMPLOYEE**—The individual listed on the Execution Page (Page 1) of Form R31 as the contact employee must be authorized to represent on behalf of the covered SRO that the information provided on this Form R31 is complete and accurate.
7. **FORMAT**—A covered SRO must file this Form R31 with the Commission in paper. Please type all information. Use only the current version of Form R31 or a reproduction. Attach an Execution Page (Page 3) with an original manual signature.
8. **WHERE TO FILE AND NUMBER OF COPIES**—Submit one original and two copies of Form R31 to: Securities and Exchange Commission; Attention: Form R31; Office of Economic Analysis; 450 Fifth Street, NW.; Washington, DC 20549-1105.
9. **PAPERWORK REDUCTION ACT DISCLOSURE**
 - Form R31 requires covered SROs to provide data regarding all covered sales and covered round turn transactions having a charge date in the month for which this form is being submitted.
 - An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 3(a)(1), 5, 6(a), and 23(a) of the Exchange Act (15 U.S.C. 78c(a)(1), 78e, 78f(a), and 78w(a)) authorize the Commission to collect information on this Form R31.
 - Form R31 is designed to enable the Commission to determine the amount of fees and assessments that are due from every covered SRO under Section 31 of the Exchange Act.
 - The Commission has estimated that each respondent will spend, on average, approximately 1.6 hours completing this Form R31. This average includes designated clearing agencies as respondents.
 - Any member of the public may direct to the Commission any comments concerning the accuracy of this burden estimate and any suggestions for reducing this burden.
 - No assurance of confidentiality is given by the Commission with respect to the responses made in Form R31. The public has access to the information contained in Form R31.
 - This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. 3507. The applicable Privacy Act system of records is SEC-2 and the routine uses of the records are set forth at 40 FR 39255 (August 27, 1975) and 41 FR 5318 (February 5, 1976).

Form R31 Page 1	U.S. SECURITIES AND EXCHANGE COMMISSION WASHINGTON, DC 20549 FORM FOR REPORTING COVERED SALES AND COVERED ROUND TURN TRANSACTIONS UNDER SECTION 31 OF THE SECURITIES EXCHANGE ACT OF 1934	Date filed (MM/DD/YYYY)
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WARNING: INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS

1. State the name of the covered SRO:
2. State the month and year for which this Form R31 is being filed:
3. Provide the following information for the contact employee:

Name:
Title:
Telephone Number:
E-mail Address:
Street Address:

PART I

QUESTIONS 4–6 TO BE COMPLETED BY COVERED EXCHANGES

4. Provide the aggregate dollar amount of covered sales of equity securities that: (a) occurred on the exchange; (b) had a charge date in the month of this report; and (c) the exchange reported to a designated clearing agency, as reflected in the data provided by a designated clearing agency:
(A)
(B)
5. Provide the aggregate dollar amount of covered sales of options that: (a) occurred on the exchange; (b) had a charge date in the month of this report; and (c) the exchange reported to a designated clearing agency, as reflected in the data provided by a designated clearing agency:
(A)
(B)
6. Provide the total number of covered round turn transactions that: (a) occurred on the exchange; (b) had a charge date in the month of this report; and (c) the exchange reported to a designated clearing agency:

QUESTION 7 TO BE COMPLETED BY COVERED ASSOCIATIONS

7. Provide the aggregate dollar amount of covered sales of equity securities that: (a) occurred by or through any member of the association; (b) had a charge date in the month of this report; and (c) resulted from the exercise of a physical delivery exchange-traded option, as reflected in the data provided by a designated clearing agency:
(A)
(B)

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PART II**QUESTIONS 8–9 TO BE COMPLETED BY COVERED EXCHANGES**

8. Provide the aggregate dollar amount of covered sales that: (a) occurred on the exchange; (b) had a charge date in the month of this report; (c) the covered exchange captured in a trade reporting system; and (d) were reported to a designated clearing agency by a qualified special representative:
- (A)
(B)
9. Provide the aggregate dollar amount of covered sales that: (a) occurred on the exchange; (b) had a charge date in the month of this report; (c) the exchange captured in a trade reporting system; and (d) were ex-clearing transactions:
- (A)
(B)

QUESTION 10 TO BE COMPLETED BY COVERED ASSOCIATIONS

10. For each trade reporting system of the association, provide the aggregate dollar amount of covered sales that: (a) occurred by or through a member of the association otherwise than on a national securities exchange; (b) had a charge date in the month of this report; and (c) the association captured in a trade reporting system:
- Name of Trade Reporting System:
- (A)
(B)
- Name of Trade Reporting System:
- (A)
(B)

PART III**QUESTION 11 TO BE COMPLETED BY COVERED EXCHANGES**

11. Provide the aggregate dollar amount of covered sales that: (a) occurred on the exchange; (b) had a charge date in the month of this report; and (c) the exchange neither captured in a trade reporting system nor reported to a designated clearing agency:
- (A)
(B)

QUESTION 12 TO BE COMPLETED BY COVERED ASSOCIATIONS

12. Provide the aggregate dollar amount of covered sales that: (a) occurred by or through a member of the association otherwise than on a national securities exchange; (b) had a charge date in the month of this report; and (c) the association did not capture in a trade reporting system:
- (A)
(B)

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EXECUTION:

The undersigned has executed this form on behalf of, and with the authority of, the covered SRO. The undersigned and the covered SRO represent that the information and statements contained herein are current, true, and complete.

MM/DD/YY:

Name of Covered SRO:

BY:

Signature:

Print Name and Title:

This page must be completed in full with original, manual signature.

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By the Commission.

Dated: January 20, 2004.

Jill M. Peterson,*Assistant Secretary.*

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