



BOSTON  
STOCK EXCHANGE

6

March 16, 2004

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street NW  
Washington, DC 20549



Re: Proposed Rule regarding Collection Practices under Section 31 of the Exchange Act  
(Release No. 34-49104; File No. S7-05-04)

Dear Mr. Katz,

The Boston Stock Exchange, Inc. (“BSE” or “Exchange”) appreciates the opportunity to comment on the proposed rule (“Release”) captioned above. While in general agreement with the need for the standardization of collection practices for Section 31 fees across market centers, the Exchange is concerned that the methodology proposed for determining trade counts will not yield an accurate number of trades executed on each market center. Moreover, the proposed rule does not take into account trades for which Section 31 fees should not apply, such as the “riskless” leg of “riskless principle” trades. Finally, the Exchange is concerned with the administrative burden that will be imposed on market centers as a result of using a single consolidator of information as the primary source by which the Securities and Exchange Commission (“SEC” or “Commission”) seeks to reconcile its fee collection practices under Section 31.

As the Release noted, there are several methodologies currently in place across the various market centers by which those market centers calculate and collect Section 31 fees on behalf of their members. Notably, the BSE utilizes an audited, electronic and verifiable system whereby trades are automatically recorded in its trading system and SEC fees are based on the number of trades which occur on the Exchange and are reported to the consolidated tape as such. Other market centers employ similar, electronic, verifiable methodologies, although there are also market centers which utilize a sort of “honor system” among their members, whereby members self-report their

transactions for which Section 31 fees are due, on a periodic basis. The BSE agrees with the Commission that such honor systems are inherently unreliable, fraught with opportunities for abuse and essentially unauditible. However, the BSE is concerned that the Commission is attempting to address the shortcomings of a few market centers with a wholesale reworking of a system which is, in large part, not in need of reform.

In particular, the Exchange is concerned that there are several types of trades which the various market centers may treat differently, and which may be reported differently to the NSCC. For example, riskless principal trades, and their equivalent counterparts, have been historically recognized by the Commission as one trade<sup>1</sup>, despite the technical argument that two transactions may have occurred during a riskless principal transaction. Although the BSE recognizes that the language of Section 31 states that exchanges must pay a fee for sales of securities transacted on the exchange could be interpreted to mean that every single transaction must be assessed a fee, historical recognition of riskless principal trades as being a single transaction mean that these types of transactions should not be essentially double-charged a Section 31 fee by now assigning each leg of the transaction as a separate, assessable trade.

On the BSE, the BEACON trading system permits an Exchange specialist to append an identifier to the riskless leg of a transaction which identifies the riskless leg as a "CTA No-Print." This identifier allows the two legs of the single transaction to be reflected only once on the consolidated tape, thereby preventing the scenario of "tape painting" for the purpose of essentially erroneous tape revenue and volume generation. The "CTA No-Print" identifier can be appended to the riskless leg of a transaction only in the scenario whereby a member of the BSE, acting as a principal for his own account, and having received an order to buy (sell) a security that the member holds for execution on the Exchange, purchases (sells) the security from another market to offset a contemporaneous sale (purchase) to satisfy all or a portion of the original buy (sell) order at the same price. Nevertheless, each leg of these transactions is reported to NSCC, although the "riskless" leg is reported for clearing purposes only. Under the current proposal, there is no exception provided for these, as well as numerous other types of trades which may be reported to NSCC but not assessable under Section 31. Moreover, NSCC currently has no way to identify these types of transactions, and would therefore not be able to exclude them from total transaction counts without internal systems modifications.

The Exchange does not believe that the Commission's proposal is an efficient way of achieving their recognizable goal of assuring the accuracy of Section 31 fees due by each market center. Each exchange has a trade reporting system, which contains verifiable auditable records for trades executed on that exchange. It would seem to be a much simpler solution to require each Exchange to document its Section 31 fee process by submitting, or making available, internal trade reporting records. Rather, the

---

<sup>1</sup> See, e.g. Release No. 34-41208, File No. SR-NASD-98-59 (March 24, 1999, 64 FR 15386 (March 31, 1999), in which the Commission stated that it agreed with the NASD that "it is appropriate to treat riskless principal trades as one trade." The Commission went on to state that the NASD's proposal "would ensure that only one trade report results for transactions that are clearly one trade" and that, as a result, "trade reports will be more accurate."

Commission's proposal is suggesting a combination of NSCC records, which will need to be reconciled daily by each exchange<sup>2</sup>, as well as trades reported only on each market center's internal trade reporting system. The BSE is concerned that this additional, significantly burdensome process is being proposed to correct the shortcomings of a few market centers that do not have readily auditable, systematic trade reporting systems.

Additionally, the Exchange is perplexed as to why the NASD's internal ACT reporting system is deemed sufficient for the reporting of the NASD's trades, but other market center's internal trade reporting systems are not deemed adequate for the reporting of their trades for the purpose of Section 31 fee calculations. In essence, the Commission is recognizing the auditability and reliability of one market center's trade reporting system and not the auditability and reliability of all other market center's trade reporting systems. This incongruous approach ignores the nuances of the NASD's trade reporting system, and accepts the NASD's current process, whereby other market centers are being asked to insert an unnecessary and burdensome set of standardized processes into what is, in most cases, a reliable and accurate practice. Again, the perceived shortcomings of a few market centers in this arena seem to be forcing other market centers into unnecessary corrective action, the costs of which far outweigh the benefits.

The BSE also notes that much attention was dedicated in the proposing release to the notion of "charge dates." Again, the BSE believes that the energy directed to refining a new definition and new concept would be better directed to correcting the flaws of a few market centers that do not report their Section 31 fees on an auditable basis. That is, instead of attempting to instill new burdensome procedures across all market centers, with new concepts such as "charge date", the much simpler task of requiring the few market centers that do not report their Section 31 fees in an auditable, reliable fashion to standardize and systemically verify their reports, would achieve the same result in a much simpler, and more efficient way. Likewise, the question of the costs, such as those related to requiring SRO's to prepare rule change proposals<sup>3</sup> is academic in the face of the much broader, radical change being proposed.

\* \* \*

The Exchange has prepared below specific comments to the questions posed in the Solicitation of Comments Section (Section III) of the Proposing Release. As noted above, the Exchange is in general agreement with the Commission's goal of standardizing the practice of reporting transactions of the purposes of Section 31 fee

---

<sup>2</sup> Based on conversations with NSCC, the Exchange requires the institution of a new internal process to conduct a daily reconciliation of trades reported to the NSCC against those reported internally on BSE systems. This process is estimated to take a minimum of two man-hours per day. This estimate is based on current reconciliation processes which the Exchange conducts presently, and the anticipated complexity of the reconciliation process, given current complexities inherent in reconciling internally reported trades with NSCC reports.

<sup>3</sup> See Proposing Release at Section VI C.

collection by the Commission. However, the BSE believes that the practice is already standardized and auditable across most market centers, and that the shortcomings of a few market centers should not require a wholesale revision of practices and procedures which achieve the purposes and objectives of Section 31. Rather, those markets with substandard collection and reporting practices should institute auditable and reliable processes on their own, in order to conform to the requirements of the statute.

Comments in Response to Section III of Release (“Solicitation of Comments”):

**Question 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 transaction occurring on the covered exchanges? If not, is there a more appropriate source for this data?**

BSE Response: The clearing agencies are an inadequate source for the aggregate dollar amount of covered sales occurring on the covered exchanges due to various types of trades which are not reported to the clearing agencies. The more appropriate source for this data is each exchange’s trade reporting system. The Commission recognizes that the covered exchange’s trading systems will have records of those trades not reported to a clearing agency, and the BSE questions why the exchange’s trade reporting systems are only deemed sufficient in the Release for the reporting of certain types of trades (i.e. those not reported to a clearing agency) but not for all trades conducted on the exchanges.

**Question 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?**

BSE Response: The BSE does not report all transactions that occur on the Exchange to a clearing agency, and some of those that are reported are reported for clearing purposes only. NSCC and the various market centers would need to make significant systems changes to accommodate the various types of trades that are not currently reported to them, or which are reported but for clearing purposes only. The appropriate means for ensuring an accurate count of transactions which occur on an exchange is to require each market center to report their own transactions based on a verifiable, auditable process, rather than inserting a complicated process involving the clearing agencies which will be replete with exceptions and prone to error.

**Question 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?**

The BSE believes that there is need for uniformity, as this question suggests, regarding the types of trades reported for the purpose of Section 31. Clearing data, however, is not the appropriate source as the basis for Section 31 fees. With a uniform set of standards, each market center's internal trade reporting system would supply the needed data, without the addition of a cumbersome process.

**Question 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?**

BSE Response: As stated repeatedly, the Exchange believes that the most reliable means of reporting transactions which occur on an exchange is the exchange's own trade reporting system. As simple as the solution may seem, it is inherently accurate and easily auditable.

**Question 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?**

BSE Response: While the BSE offers no opinion on the reliability of ACT and TRACS, the Exchange believes that the Commission would be unfairly endorsing one market center's trade reporting system over other market center's trading systems by permitting the NASD to utilize its own internal system for reporting trades while requiring other market centers to utilize a cumbersome, expensive process which relies on an outside source of data.

**Question 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?**

BSE Response: The BSE joins in the comments offered by the other five options exchanges and the Options Clearing Corporation in response to this series of questions in their letter to Jonathan Katz, Secretary, Commission, dated March 1, 2004.

**Question 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?**

BSE Response: There are several types of transactions not reported to NSCC by the BSE, as there are from all market centers. The Exchange agrees that a set of uniform standards is needed to define precisely which types of trades should be reported for the purposes of Section 31 fee calculations.

The most accurate source of data, then, for these trades is each exchange's own internal trade reporting systems. The question then becomes why NSCC, or any other clearing agency, should be inserted into the process? The BSE does not understand why the reliability and auditability of its trade reporting system would be deemed adequate for some types of trades but not others.

**Question 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?**

BSE Response: The Exchange does not understand the rationale for requiring duplicative trade report data from several sources. Administrative burdens will not increase reliability and will likely result in a complicated processes fraught with ad-hoc case-by-case exceptions.

**Question 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?**

BSE Response: Again, the Commission would be requesting additional data from each exchange's trade reporting system. Each market center should be required to report the transactions occurring in that market center based on a reliable, auditable trade reporting system. This series of question highlights once again that the proposal will require numerous exceptions which could likely lead to it becoming unworkable and inherently unreliable. If the Commission is going to require each exchange to report some of its trades for Section 31 purposes based on records from the exchange's trade reporting system, the BSE does not understand the fundamental issue with permitting an exchange to report all of its transactions from its trade reporting system.

**Question 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?**

BSE Response: While the number of ex-clearing transactions may be small, there are numerous other types of transactions which are not reported to NSCC and would therefore not be captured for the purposes of Section 31 reporting under the proposed set of rules. The number of these trades may or may not be *de minimis*, but would need to be reported based on information from each exchange's own trade reporting system. Accordingly, the exchange's internal trade reporting systems are the only source required to achieve the Commission's objective of accurate trade reporting.

**Question 11. Is ten business days a reasonable time period to give covered SROs to prepare and submit Form R31? If not, what is a reasonable period of time?**

BSE Response: Ten business days would be enough time under the proposal. The real burden would be the daily reconciliation required between the information reported back to the exchanges by NSCC and the exchange's own internal trade reporting systems. The BSE urges the Commission to explore further the unnecessary burden imposed on the exchanges if the proposed rules were to be adopted. The BSE believes that this is a significant issue, not only in regard to the time and effort required, but because a standardized reconciliation process would need to be established across all market centers to ensure uniformity and reliability.

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

BSE Response: In light of the totality of the burden and duplicity of effort which would result from the proposed rules, the Exchange does not believe that the issue of charge dates adds significantly to the endeavor.

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

BSE Response: The BSE believes that all market centers should report their own transaction data based solely on internal trade reporting systems which are fully auditable. Self-reporting by SRO members would not be permitted.

**Question 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?**

BSE Response: If an SRO desires a designated clearing agency to pay Section 31 bills on their behalf, then the SRO should be permitted to do so. The reliability of the data to support such payments would need to be established, and transactions which went unreported to the clearing agency would need to be included in such data.

\* \* \*

Thank you again for the opportunity to comment on the proposed rules on collection practices under Section 31. If there are any questions or comments concerning this matter, please do not hesitate to contact me.

Sincerely,

  
John A. Boese  
Vice President  
Legal and Compliance

cc: Annette L. Nazareth, Director, Division of Market Regulation  
Robert L.D. Colby, Deputy Director, Division of Market Regulation  
Michael Gaw, Special Counsel, Division of Market Regulation  
Christopher Solgan, Attorney, Division of Market Regulation