

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-48303; File No. SR-NASD-2003-120)

August 8, 2003

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. to Establish a Revenue Sharing Program

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 1, 2003, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq filed the proposal pursuant to Section 19(b)(3)(A)(ii) of the Act,<sup>3</sup> and Rule 19b-4(f)(2) thereunder<sup>4</sup> as one establishing or changing a due, fee or other charge imposed by the self-regulatory organization, which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Nasdaq proposes to establish a revenue sharing program. Nasdaq will implement the proposed rule change on August 1, 2003.

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

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

The text of the proposed rule change is below. Proposed new language is in italics.<sup>5</sup>

7000. CHARGES FOR SERVICES AND EQUIPMENT

7010. System Services

(a) – (t) No change

(u) Nasdaq Revenue Sharing Program.

After Nasdaq earns total operating revenue sufficient to offset actual expenses and working capital needs, a percentage of all Market Participant Operating Revenue (“MPOR”) shall be eligible for sharing with Nasdaq Quoting Market Participants (as defined in Rule 4701). MPOR is defined as operating revenue that is generated by Nasdaq Quoting Market Participants. MPOR consists of transaction fees, technology fees, and market data revenue that is attributable to Nasdaq Quoting Market Participant activity in Nasdaq National Market and SmallCap Market securities. MPOR shall not include any investment income or regulatory monies. The sharing of MPOR shall be based on each Nasdaq Quoting Market Participant’s pro rata contribution to MPOR. In no event shall the amount of revenue shared with Nasdaq Quoting Market Participants exceed MPOR. To the extent market data revenue is subject to year-end adjustment, MPOR revenue may be adjusted accordingly.

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

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV

<sup>5</sup> Note that subsection (t) of Rule 7010 has been reserved for the rule change proposed in SR-NASD-2003-114 (July 22, 2003), which has been submitted for Commission approval pursuant to Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2).

below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

As part of an ongoing effort to reduce the costs incurred by market participants to use Nasdaq services, Nasdaq is implementing a general revenue sharing program based on The Cincinnati Stock Exchange's revenue sharing program, as adopted in 1999 and subsequently amended.<sup>6</sup> The purpose of the proposed rule change is to provide an incentive for growth in member activity. To compete more effectively, Nasdaq proposes to reduce significantly the cost of doing business for Nasdaq Quoting Market Participants (as defined in Rule 4701) by means of a quarterly revenue sharing program, without diminishing the quality of the market, including regulatory quality.<sup>7</sup>

The proposed rule change contemplates Nasdaq sharing with Nasdaq Quoting Market Participants (i.e., market makers and ECNs that participate in SuperMontage) all or a portion of Nasdaq's Market Participant Operating Revenue ("MPOR") after operating expenses and working capital needs have been met. MPOR is defined as all operating revenue that is generated by Nasdaq Quoting Market Participants. MPOR consists of transaction fees, technology fees, and market data revenue that is attributable to Nasdaq Quoting Market

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<sup>6</sup> Securities Exchange Act Release No. 41082 (February 22, 1999), 64 FR 10035 (March 1, 1999) (SR-CSE-99-02) (notice); Securities Exchange Act Release No. 41286 (April 14, 1999), 64 FR 19843 (April 22, 1999) (SR-CSE-99-02) (approval order); Securities Exchange Act Release No. 46688 (October 18, 2002), 67 FR 65816 (October 28, 2002) (SR-CSE-2002-14) (notice of filing and immediate effectiveness).

<sup>7</sup> See infra note 8.

Participant activity in Nasdaq National Market and SmallCap Market securities. All regulatory monies and investment income are excluded from MPOR.

Under the proposal, Nasdaq's Board of Directors (acting through its Finance Committee or as a whole) would have the authority to determine on an ongoing basis the appropriate amount of MPOR to be shared with Nasdaq Quoting Market Participants. In making this determination, the Board would be guided by the need to balance the objective of sharing meaningful portions of MPOR with the objective of maintaining Nasdaq's financial integrity.<sup>8</sup> To simplify the administration of the revenue sharing program and smooth out monthly expense fluctuations, the program will operate on a quarterly basis. In addition, to the extent that Nasdaq market data revenue is subject to a year-end adjustment, revenues distributed to Nasdaq Quoting Market Participants are subject to adjustment accordingly, to ensure that member receipts of market data revenue are consistent with the year-end true up procedures applied under the Nasdaq UTP Plan.

MPOR will be shared with Nasdaq Quoting Market Participants on a pro rata basis. After Nasdaq has accounted for operating expenses and working capital contributions, each Nasdaq Quoting Market Participant will receive a percentage of the MPOR to be shared that is equal to that firm's percentage contribution to MPOR. In no event will the amount of revenue shared with Nasdaq Quoting Market Participants exceed MPOR.

## 2. Statutory Basis

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<sup>8</sup> In particular, Nasdaq will not compromise its regulatory responsibilities by sharing revenue that would more appropriately be used to fund regulatory responsibilities. Nasdaq will be mindful of its regulatory responsibilities when determining its working capital needs. See, Securities Exchange Act Release No. 41286 (April 14, 1999), 64 FR 19843, 19844 (April 22, 1999) (SR-CSE-99-02).

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>9</sup> in general, and with Section 15A(b)(6) of the Act,<sup>10</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Nasdaq believes that the proposed will change will create an incentive for members to use Nasdaq systems, thereby increasing competition, which, in turn, will enhance the National Market System.

In addition, Nasdaq believes that the proposed rule change is consistent with Section 15A(b)(5) of the Act,<sup>11</sup> in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which the NASD operates or controls. Specifically, the proposal provides for revenue sharing with Nasdaq Quoting Market Participants, who are primarily responsible for Nasdaq's financial viability and growth.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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<sup>9</sup> 15 U.S.C. 78o-3.

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

<sup>11</sup> 15 U.S.C. 78o-3(b)(5).

The proposed rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>12</sup> and subparagraph (f)(2) of Rule 19b-4 thereunder,<sup>13</sup> because it establishes or changes a due, fee, or other charge imposed by the Association. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Association. All submissions

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<sup>12</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>13</sup> 17 CFR 240.19b-4(f)(2).

should refer to file number SR-NASD-2003-120 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).