

July 7, 2003

Florence Harmon
Senior Special Counsel
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **SR-NASD-2003-106** – Amendments to Pilot Rule in IM-10100(f) and (g) of the Code of Arbitration Procedure to Require Industry Parties in Arbitration to Waive Application of Contested California Arbitrator Disclosure Standards, upon the Request of Customers or Associated Persons; Immediate Effectiveness Requested

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Laura Gansler, Counsel, NASD Dispute Resolution, at (202) 728-8275; e-mail laura.gansler@nasd.com. The fax number is (202) 728-8833.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

Enclosures

File No. SR-NASD-2003-106
Consists of 17 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend the pilot rule in IM-10100(f) and (g) of the Code of Arbitration Procedure. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * *

10000. Code of Arbitration Procedure

IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member or a person associated with a member to:

(a) – (e) No change.

(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if all the parties in the case who are customers, or associated persons with a claim against a member firm or another associated person, have waived application of the California Standards in that case. The written waiver by the customer or the associated person asserting the claim against a member or associated person under the Code shall constitute and operate as a waiver for all member firms or associated persons against whom the claim has been filed. This rule applies to claims brought in California against all member

firms and associated persons, including terminated or otherwise inactive member firms or associated persons. [; or

(g) fail to waive the California Standards, if all the parties in the case who are associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case.]

Remainder unchanged.

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Dispute Resolution at its meeting on June 17, 2003, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors, acting through its Executive Committee, approved the proposed rule change at its meeting on July 1, 2003. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD requests that the rule change become effective on filing and that it become operative on July 14, 2003.

(b) Questions regarding this rule filing may be directed to Laura Gansler, Counsel, NASD Dispute Resolution, at (202) 728-8275.

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

(a) Purpose

Background

On July 1, California introduced new rules governing the arbitration process in that state. The rules were designed to address conflicts of interest in private arbitration forums that are not part of a federal regulatory system overseen on a uniform, national basis by the SEC. The California Standards conflict with NASD's current arbitrator disclosure rules. Because NASD could not both administer its arbitration program in accordance with its own rules and comply with the new California Standards at the same time, NASD initially suspended the appointment of arbitrators in cases in California, but offered parties several options for pursuing their cases.¹

On September 5, 2002, the Chairmen of NASD and NYSE received a request from Harvey L. Pitt, then Chairman of the SEC, to further expedite processing of arbitration claims involving California parties. In response, NASD proposed implementation on an accelerated basis of a six-month pilot amendment to IM-10100 that would require all parties that are member firms or associated persons to waive the California Standards if all the parties in the case who are customers, or associated persons with a statutory employment discrimination claim, have waived application of the California Standards in that case. Under such a waiver,

¹ These measures included providing venue changes for arbitration cases, using non-California arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.

the case would proceed in California. The Commission approved the proposed rule change for a six-month period ending March 30, 2003,² and recently extended the pilot rule for an additional six-month period.³ The pilot rule will expire on September 30, 2003.

Description of Proposed Rule Change

The proposed rule change would amend the pilot rule in several respects. First, it would extend the rule to apply to all claims by an associated person against a member firm or another associated person, as well as to all customer claims. Currently, the pilot rule only applies to customer claims and to statutory discrimination claims brought by an associated person against a member firm. As a result, cases involving other claims by associated persons against member firms or other associated persons (“industry respondents”) cannot proceed if the industry respondents do not agree to waive the California Standards. To permit these cases to move forward, the proposed rule change would expand the current pilot rule to require that if an associated person with a claim against an industry respondent waives the application of the California Standards, all other industry respondents must also waive the application of the California Standards in that case. This change is consistent with New York Stock Exchange Rule 600(g), and would permit claims by associated persons against industry respondents in California to go forward.

The proposed rule change would also provide that, if a customer, or an associated person with a claim against an industry respondent, agrees to waive the application of the California Standards, and an industry respondent has not signed and returned a waiver form

² Exchange Act Release No. 46562 (September 26, 2002) (File No. SR-NASD-2002-126), 67 Federal Register 62085 (October 3, 2002).

³ Exchange Act Release No. 47631 (April 3, 2003)(File No. SR-NASD 2003-64), 68 Federal Register 17713 (April 10, 2003).

by the time its answer is due, the industry respondent will be deemed to have waived the application of the standards in that case. Currently, NASD requires member firms and associated persons covered by the rule to sign and return the waiver agreement. NASD staff often must call industry respondents to remind them to send in their waiver forms. When execution of the agreement by the respondent member or associated person is mandatory under the rule, this requirement adds an unnecessary administrative step to the arbitration process. Therefore, NASD is proposing to amend the pilot rule to provide, as NYSE Rule 600(g) currently does, that a written waiver by a customer or an associated person who is asserting a claim against a member or associated person under the Code will constitute a waiver for all member firms or associated persons against whom the claim has been filed.

Finally, NASD is proposing to amend the pilot rule to clarify that it applies to respondents who are terminated members and associated persons.⁴ As of June 5, 2003, there were 33 cases in which all customers and active industry parties had signed waivers, but the terminated members or associated persons had not signed. Another 51 pending cases involved both active and terminated industry parties that had not yet signed waivers; these cases could not proceed even if the active industry parties were deemed to have waived, unless the rule covered terminated parties. The proposed rule change will eliminate any confusion regarding the scope of the rule and will facilitate the administration of cases against such parties in California while the rule is in effect.

(b) Statutory Basis

⁴ An associated person or member firm's obligation to arbitrate under the NASD Code of Arbitration Procedure survives resignation or termination from membership. See O'Neel v. NASD, 667 F.2d 804 (9th Cir. 1982); Muh v. Newburger, Loeb & Co., Inc., 540 F.2d 970 (9th Cir. 1976).

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change will allow customers and associated persons with claims against a member firm or another associated person to exercise their contractual rights to proceed in arbitration in California, notwithstanding the confusion caused by the disputed California Standards.

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

NASD 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.

5. 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.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder, in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any

significant burden on competition; and does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. NASD believes that the proposed rule change, which would make NASD's pilot rule consistent with NYSE Rule 600(g), would protect investors and further the public interest by allowing customers and associated persons with claims against a member firm or another associated person to exercise their contractual rights to proceed in arbitration in California, notwithstanding the confusion caused by the disputed California Standards.

NASD requests the Commission to waive the five-day advance notice requirement and the requirement that the rule change not become operative for 30 days after filing. NASD staff has discussed the substance of the proposed rule change with Commission staff in advance of filing. NASD believes that waiving the five-day pre-filing provision and the 30-day operative delay is consistent with the protection of investors and the public interest. Waiving the pre-filing requirement and accelerating the operative date will provide investors and associated persons with claims against industry parties a mechanism to resolve their disputes. NASD proposes to make the proposed rule change operative on July 14, 2003.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change would make NASD's pilot rule in IM-10100(f) consistent with NYSE Rule 600(g).

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly

caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD

BY: _____
Barbara Z. Sweeney , Senior Vice President and
Corporate Secretary

Date: July 7, 2003

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-

File No. SR-NASD-2003-106)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments to Pilot Rule in IM-10100(f) and (g) of the Code of Arbitration Procedure to Require Industry Parties in Arbitration to Waive Application of Contested California Arbitrator Disclosure Standards upon the Request of Customers or Associated Persons

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on _____, the National Association of Securities Dealers, Inc. (“NASD”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Dispute Resolution. NASD has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by 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

NASD is proposing to amend the pilot rule in IM-10100(f) and (g) of the NASD Code of Arbitration Procedure to expand and clarify the scope of the requirement that industry parties

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR § 240.19b-4

waive application of the contested California Arbitrator Disclosure Standards upon the request of customers or associated persons. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * *

10000. Code of Arbitration Procedure

IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure

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(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if all the parties in the case who are customers, or associated persons with a claim against a member firm or another associated person, have waived application of the California Standards in that case. The written waiver by the customer or the associated person asserting the claim against a member or associated person under the Code shall constitute and operate as a waiver for all member firms or associated persons against whom the claim has been filed. This rule applies to claims brought in California against all member firms and associated persons, including terminated or otherwise inactive member firms or associated persons. [; or

(g) fail to waive the California Standards, if all the parties in the case who are associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case.]

Remainder unchanged.

* * *

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD 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 below. NASD 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

(a) Purpose

Background

On July 1, California introduced new rules governing the arbitration process in that state. The rules were designed to address conflicts of interest in private arbitration forums that are not part of a federal regulatory system overseen on a uniform, national basis by the SEC. The California Standards conflict with NASD's current arbitrator disclosure rules. Because NASD could not both administer its arbitration program in accordance with its own rules and comply with the new California Standards at the same time, NASD initially suspended the appointment of arbitrators in cases in California, but offered parties several options for pursuing their cases.⁴

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Harvey L. Pitt, then Chairman of the SEC, to further expedite processing of arbitration claims involving California parties. In response, NASD proposed implementation on an accelerated basis of a six-month pilot amendment to IM-10100 that would require all parties that are member firms or associated persons to waive the California Standards if all the parties in the case who are customers, or associated persons with a statutory employment discrimination claim, have waived application of the California Standards in that case. Under such a waiver, the case would proceed in California. The Commission approved the proposed rule change for a six-month period ending March 30, 2003,⁵ and recently extended the pilot rule for an additional six-month period.⁶ The pilot rule will expire on September 30, 2003.

Description of Proposed Rule Change

The proposed rule change would amend the pilot rule in several respects. First, it would extend the rule to apply to all claims by an associated person against a member firm or another associated person, as well as to all customer claims. Currently, the pilot rule only applies to customer claims and to statutory discrimination claims brought by an associated person against a member firm. As a result, cases involving other claims by associated persons against member firms or other associated persons (“industry respondents”) cannot proceed if the industry respondents do not agree to waive the California Standards. To permit these cases to move forward, the proposed rule change would expand the current pilot rule to require that if an associated person with a claim against an industry respondent waives the application of the

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⁶ Exchange Act Release No. 47631 (April 3, 2003)(File No. SR-NASD 2003-64), 68 Federal Register 17713 (April 10, 2003).

California Standards, all other industry respondents must also waive the application of the California Standards in that case. This change is consistent with New York Stock Exchange Rule 600(g), and would permit claims by associated persons against industry respondents in California to go forward.

The proposed rule change would also provide that, if a customer, or an associated person with a claim against an industry respondent, agrees to waive the application of the California Standards, and an industry respondent has not signed and returned a waiver form by the time its answer is due, the industry respondent will be deemed to have waived the application of the standards in that case. Currently, NASD requires member firms and associated persons covered by the rule to sign and return the waiver agreement. NASD staff often must call industry respondents to remind them to send in their waiver forms. When execution of the agreement by the respondent member or associated person is mandatory under the rule, this requirement adds an unnecessary administrative step to the arbitration process. Therefore, NASD is proposing to amend the pilot rule to provide, as NYSE Rule 600(g) currently does, that a written waiver by a customer or an associated person who is asserting a claim against a member or associated person under the Code will constitute a waiver for all member firms or associated persons against whom the claim has been filed.

Finally, NASD is proposing to amend the pilot rule to clarify that it applies to respondents who are terminated members and associated persons.⁷ As of June 5, 2003, there were 33 cases in which all customers and active industry parties had signed waivers, but the

terminated members or associated persons had not signed. Another 51 pending cases involved both active and terminated industry parties that had not yet signed waivers; these cases could not proceed even if the active industry parties were deemed to have waived, unless the rule covered terminated parties. The proposed rule change will eliminate any confusion regarding the scope of the rule and will facilitate the administration of cases against such parties in California while the rule is in effect.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change will allow customers and associated persons with claims against a member firm or another associated person to exercise their contractual rights to proceed in arbitration in California, notwithstanding the confusion caused by the disputed California Standards.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD 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

⁷ An associated person or member firm's obligation to arbitrate under the NASD Code of Arbitration Procedure survives resignation or termination from membership. See O'Neel v. NASD, 667 F.2d 804 (9th Cir. 1982); Muh v. Newburger, Loeb & Co., Inc., 540 F.2d 970 (9th Cir. 1976).

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

NASD has designated the proposed rule change as one that: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. Therefore, the foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act 6 and Rule 19b-4(f)(6) thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate the rule change if it appears to the Commission that the action is necessary or appropriate in the public interest, for the protection of investors, or would otherwise further the purposes of the Act.

Pursuant to Rule 19b-4(f)(6)(iii) under the Act, the proposal may not become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, and the self-regulatory organization must file notice of its intent to file the proposed rule change at least five business days beforehand.

NASD has requested that the Commission waive the five-day pre-filing requirement and the 30-day operative delay so that the proposed rule change will become immediately effective upon filing. The Commission believes that waiving the five-day pre-filing provision and the 30-day operative delay is consistent with the protection of investors and the public interest. The

proposed rule change will make the NASD pilot rule consistent with NYSE Rule 600(g).

Waiving the pre-filing requirement and accelerating the operative date will provide investors and associated persons with claims against industry parties a mechanism to resolve their disputes. For these reasons, the Commission designates the proposed rule change effective immediately and operative on July 14, 2003.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 NASD. All submissions should refer to the file number in the caption above 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, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary