

Notice to Members

AUGUST 2004

SUGGESTED ROUTING

Executive Representatives
Legal and Compliance
Senior Management

KEY TOPICS

NASD By-Laws
Non-Payment of Arbitration Awards

GUIDANCE

Non-Payment of Arbitration Awards

NASD Extends Jurisdiction to Suspend Formerly Associated Persons Who Fail to Pay Arbitration Awards

Executive Summary

The Securities and Exchange Commission (SEC) has approved two amendments to the NASD By-Laws that further strengthen NASD's ability to prevent formerly associated persons from re-entering the securities industry if they have failed to pay awards or settlements relating to arbitrations or mediations submitted under NASD Rules.

Specifically, the amendments allow NASD to institute suspension proceedings against a formerly associated person for failing to pay an award or settlement for a period of two years after the award was rendered or the settlement agreement was entered into. In addition, the amendments provide that NASD's authority to suspend an associated or formerly associated person for failure to comply with an award or settlement relating to a arbitration or mediation under NASD rules is not limited to suspending his or her NASD registration, but now also includes the authority to suspend his or her ability to associate with a member *in any capacity* until the award or settlement is paid.

Included with this *Notice* is Attachment A, the text of the amendments to the NASD By-Laws.

NASD will implement these amendments on September 9, 2004.

Questions/Further Information

Questions concerning this *Notice* should be directed to Laura Gansler, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8275; or Jean I. Feeney, Vice President and Chief Counsel, Dispute Resolution, at (202) 728-6959.

Background and Discussion

NASD Jurisdiction for Failure to Pay Awards While Person is Associated with a Member

Currently, NASD may suspend or bar an associated person from further associating with a member firm based on a range of conduct that commences while the person is associated with a member, including failing to comply with an award or settlement agreement relating to an arbitration or mediation filed under NASD Rules.² Pursuant to Article V, Section 4 of the NASD By-Laws, NASD may also institute such proceedings for a period of two years after a person terminates his or her association with a member based on conduct that occurred while the person was associated with the member.³ Suspending a formerly associated person prevents him or her from re-entering the industry for the duration of the suspension.

Prior to the amendments that are the subject of this Notice, however, NASD did not have jurisdiction over formerly associated persons for conduct that commenced after an associated person terminated his or her association. Because associated persons remain subject to arbitration or mediation claims for conduct that occurred during their association even after they terminate their association with a member, a claim may not be resolved, or even filed, until after that time. In such cases, NASD lacked the ability to bring suspension proceedings for failure to pay such awards.⁴ In addition, NASD was concerned that a person associated with a member might deliberately terminate his or her association with the member once aware that an arbitration award was about to be entered against him or her in order to avoid sanction by NASD for failure to pay any award or settlement agreement resulting from the proceeding.

Expansion of NASD Jurisdiction for Failure to Pay Awards after Association is Terminated

To address this concern, NASD has amended Article V to add a new Section 4(b), which provides that NASD retains jurisdiction to institute suspension proceedings against formerly associated persons for failing to pay an award or settlement in a matter submitted for arbitration or mediation pursuant to the NASD Rules for a period of two years after the entry of the award or settlement. This is true regardless of when the arbitration or mediation claim was filed, as long as the failure to pay the award or settlement occurred **after** termination. Formerly associated persons who failed to pay an award or settlement while associated remain subject to suspension proceedings for that failure to pay for two years from the date of termination, pursuant to Article V, Section 4(a).⁵

In addition, NASD has amended Article VI, Section 3 of its By-Laws to clarify that its authority is not limited to suspending the registration of an associated person, but also includes the authority to suspend the ability of an associated or formerly associated person to associate with a member—meaning that a person cannot be employed even in a non-registered capacity if he or she is suspended for failing to pay an arbitration award or settlement.

NASD believes that, collectively, these two amendments will significantly enhance its ability to prevent formerly associated persons who fail to pay awards or settlements relating to arbitrations or mediations under NASD Rules from re-entering the industry until the award or settlement is paid.

Implementation Date

NASD will implement these amendments beginning on September 9, 2004.

Endnotes

- 1 Securities Exchange Act Rel. No. 49845 (June 10, 2004), 69 FR 33968 (June 17, 2004) (File No. SR-NASD-2003-069) (Order of Approval).
- 2 Article VI, Section 3 of the NASD By-Laws; NASD Rule 9554(a).
- 3 As a result of these amendments, Article V, Section 4 of the NASD By-Laws is now Article V, Section 4(a). The word "termination" as used in Article V, Section 4 means the following: (1) when applied to associated persons who are registered with NASD, that time when a Form U5 with respect to such person is filed with NASD; or (2) when applied to associated persons who are not registered with NASD, that time when such person ceases to be associated with a member; regardless of whether, in the case of (1) or (2), such termination is voluntary or involuntary, or with or without cause.
- 4 For example, in at least one case, the NASD Board of Governors directed the Office of Hearing Officers to dismiss, for lack of jurisdiction, a proceeding alleging failure to pay an arbitration award against a person who terminated his association after the arbitration proceeding commenced but before an arbitration award was entered against him. The Board reasoned that, because the conduct underlying the proceeding (i.e., the failure to pay an arbitration award) did not begin until after the person's association terminated, NASD did not retain jurisdiction over the person under Article V, Section 4 of the NASD By-Laws. See *Department of Enforcement v. Jonathan Winston*, Non-Summary Proceeding No. ARB980006 (Office of Hearing Officers, December 15, 1998).
- 5 As NASD stated in the rule filing, the new provision does not in any way limit the authority of NASD to act pursuant to what was Section 4, and is now Section 4(a).

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ATTACHMENT A

Text of Rule Change

New language is underlined; deletions are in brackets.

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Article V

REGISTERED REPRESENTATIVES AND ASSOCIATED PERSONS

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Retention of Jurisdiction

Sec. 4. (a) A person whose association with a member has been terminated and is no longer associated with any member of [the] NASD or a person whose registration has been revoked or canceled shall continue to be subject to the filing of a complaint under the NASD Rules [of the Association] based upon conduct [which] that commenced prior to the termination, revocation, or cancellation or upon such person's failure, while subject to [the] NASD's jurisdiction as provided herein, to provide information requested by [the] NASD pursuant to the NASD Rules [of the Association], but any such complaint shall be filed within:

[(a)] (i) two years after the effective date of termination of registration pursuant to Section 3, provided, however that any amendment to a notice of termination filed pursuant to Section 3(b) that is filed within two years of the original notice [which] that discloses that such person may have engaged in conduct actionable under any applicable statute, rule, or regulation shall operate to recommence the running of the two-year period under this subsection;

[(b)] (ii) two years after the effective date of revocation or cancellation of registration pursuant to the NASD Rules [of the Association]; or

[(c)] (iii) in the case of an unregistered person, [within] two years after the date upon which such person ceased to be associated with the member.

(b) A person whose association with a member has been terminated and is no longer associated with any member of NASD shall continue to be subject to a proceeding to suspend, consistent with Article VI, Section 3 of the By-Laws, his or her ability to associate with a member based on such person's failure to comply with an arbitration award or a written and executed settlement agreement obtained in connection with an arbitration or mediation submitted for disposition pursuant to the NASD Rules, provided that such proceeding is instituted within two years after the date of entry of such award or settlement.

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Article VI

DUES, ASSESSMENTS, AND OTHER CHARGES

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Suspension or Cancellation [of Membership or Registration]

Sec. 3. (a) [The] NASD after 15 days notice in writing, may suspend or cancel the membership of any member or the registration of any person in arrears in the payment of any fees, dues, assessments, or other charges or for failure to furnish any information or reports requested pursuant to Section 2 [, or for failure to comply with an award of arbitrators properly rendered pursuant to the Rules of the Association, where a timely motion to vacate or modify such award has not been made pursuant to applicable law or where such a motion has been denied, or for failure to comply with a written and executed settlement agreement obtained in connection with an arbitration or mediation submitted for disposition pursuant to the Rules of the Association].

(b) NASD after 15 days notice in writing, may suspend or cancel the membership of any member or suspend from association with any member any person, for failure to comply with an award of arbitrators properly rendered pursuant to the NASD Rules, where a timely motion to vacate or modify such award has not been made pursuant to applicable law or where such a motion has been denied, or for failure to comply with a written and executed settlement agreement obtained in connection with an arbitration or mediation submitted for disposition pursuant to the NASD Rules.

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