

Notice to Members

APRIL 2005

SUGGESTED ROUTING

Legal & Compliance
Senior Management

KEY TOPICS

Arbitration
Books and Records
Predispute Arbitration Agreements
Rule 3110

GUIDANCE

Predispute Arbitration Agreements

SEC Approves Amendments to NASD Rule Governing
Predispute Arbitration Agreements with Customers

Executive Summary

NASD Rule 3110(f) governs a member's use of predispute arbitration agreements with customers. The Securities and Exchange Commission (SEC) has approved changes to NASD Rule 3110(f) to conform the NASD delivery requirement for predispute arbitration agreements with the SEC's recordkeeping rules.¹ The rule change also extends the date by which firms must begin using the disclosure required by the recent changes to NASD Rule 3110(f)(1) from May 1, 2005 until June 1, 2005.² The changes to NASD Rule 3110(f) are attached as Attachment A (new language is underlined; deletions are in brackets).

Questions/Further Information

Questions concerning this *Notice* may be directed to Laura Gansler, Associate General Counsel, Office of General Counsel (OGC), Regulatory Policy and Oversight (RPO), at (202) 728-8275; or Brant K. Brown, Counsel, OGC, RPO, at (202) 728-6927.

Discussion

Delivery Requirement

On November 22, 2004, the SEC approved changes to NASD Rule 3110(f), which governs the use of predispute arbitration agreements with customers.³ The primary purposes of those changes were to require enhanced disclosure to customers about the arbitration process and to clarify the use of certain clauses in predispute arbitration agreements. Those changes also required that members provide a copy of any customer agreement containing a predispute arbitration clause to the customer, who must acknowledge receipt thereof on the agreement or on a separate document, at the time of signing.⁴ The rule change announced in this *Notice* amends the time requirement for delivery of a copy of the customer agreement from the time of signing to within 30 days of signing.⁵ This change conforms the delivery requirement in NASD Rule 3110(f)(2)(B) to that in the SEC's recordkeeping rules.⁶

As amended, NASD Rule 3110(f)(3)(A) requires members to provide customers who request a copy of any predispute arbitration clause or client agreement with a copy within 10 business days of the request. The primary purpose of this provision is to address instances in which members have refused to provide additional copies of agreements to customers who requested them after a dispute arose, making it difficult for customers who had misplaced their original copies to assess their rights and obligations under the agreement. However, it is possible that a customer may make a request pursuant to this provision before the original copy is delivered as required by Rule 3110(f)(2)(B). In such cases, members must provide a copy of the agreement within 10 business days. For example, if a customer requests a copy of the agreement on the date of signing, the member must provide the copy to the customer within 10 business days of receiving that request. However, members may not extend the 30-day time period for compliance with the delivery requirement in NASD Rule 3110(f)(2)(B), even though a member has 10 business days in which to provide a copy of the agreement to a customer upon request. For example, if a customer requests a copy of the customer agreement 25 days after signing, the member still is required to provide the customer with the copy within 30 days of the signing date (rather than within 10 business days of the date the firm received the request). The language added to NASD Rule 3110(f)(3)(A) addresses this situation.

Extension of Compliance Date

The changes to NASD Rule 3110(f) approved by the SEC on November 22, 2004, are scheduled to become effective on May 1, 2005. To give members more time to amend their customer agreements to *comply with the changes to NASD Rule 3110(f)(1) announced in Notice to Members (NTM) 05-09*, the compliance date by which members must begin using the disclosure required by those changes has been extended from May 1, 2005 until June 1, 2005.⁷

Effective Date

By May 1, 2005, members are required to comply with the recent changes to NASD Rule 3110(f) as set forth in *NTM 05-09* and this *Notice*, with the exception of the new disclosure required by NASD Rule 3110(f)(1). Members are not required to use customer agreements with the new disclosure until June 1, 2005; however, members may use the new language earlier if they so choose. Beginning June 1, 2005, all customer agreements containing predispute arbitration clauses must contain the new disclosure required by NASD Rule 3110(f)(1).

Endnotes

- 1 SEC Rel. No. 34-51526 (Apr. 12, 2005), 70 Fed. Reg. 20407 (Apr. 19, 2005) (SR-NASD-2005-045).
- 2 NASD announced the changes to the predispute arbitration agreement disclosure requirements in *Notice to Members 05-09*.
- 3 SEC Rel. No. 34-50713 (Nov. 22, 2004), 69 Fed. Reg. 70293 (Dec. 3, 2004) (SR-NASD-98-74).
- 4 Before the changes, members were required to provide copies of predispute arbitration agreements to customers; however, the rule did not specify when they must do so.
- 5 The rule change also makes a technical amendment by renumbering the four subparagraphs in NASD Rule 3110(f)(4) to conform the numbering in those subparagraphs to existing NASD rule format.
- 6 See SEC Rule 17a-3(a)(17)(i)(B)(1); SEC Rel. No. 34-44992 (Oct. 26, 2001), 66 Fed. Reg. 55817 (Nov. 2, 2001). The earlier changes to NASD Rule 3110(f) were first filed in 1998, prior to the adoption of the SEC rule. See 69 Fed. Reg. at 70293.
- 7 The effective date of the Rule 3110 changes was originally linked to the effective date of amendments to NASD Rule 10304, governing time limits on filing claims in arbitration, which will also take effect on May 1, 2005. See SEC Rel. No. 34-50714 (Nov. 22, 2004), 69 Fed. Reg. 69971 (Dec. 1, 2004) (SR-NASD-2003-101). Extension of the compliance date for NASD Rule 3110(f)(1) does not extend the effective date of the bifurcation provision in NASD Rule 3110(f)(5), which remains the same (May 1, 2005) as the amendments to NASD Rule 10304, or the applicability of any provision in NASD Rule 10304.

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ATTACHMENT A

New language is underlined; deletions are in brackets.

3110. Books and Records

(a) – (f)(2)(A) No change.

(f)

(2) (B) [At the time] Within thirty days of signing, a copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.

(3) (A) A member shall provide a customer with a copy of any predispute arbitration clause or customer agreement executed between the customer and the member, or inform the customer that the member does not have a copy thereof, within ten business days of receipt of the customer's request. If a customer requests such a copy before the member has provided the customer with a copy pursuant to subparagraph (2)(B) of this Rule, the member must provide a copy to the customer by the earlier date required by this subparagraph (3)(A) or by subparagraph (2)(B).

(f)(3)(B) No change.

(4) No predispute arbitration agreement shall include any condition that:

(A) [(i)] limits or contradicts the rules of any self-regulatory organization;

(B) [(ii)] limits the ability of a party to file any claim in arbitration;

(C) [(iii)] limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement;

(D) [(iv)] limits the ability of arbitrators to make any award.

(f)(5) – (h) No change.