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August 11, 1999

Richard C. Strasser
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Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Mail Stop 10-1

**Re: File No. SR-NASD-99-21 - Creation of a Separate Subsidiary to Administer
Dispute Resolution Programs - Response to Comments**

Dear Mr. Strasser:

NASD Regulation hereby responds to the comment letter received by the Commission in response to the publication in the *Federal Register* of Notice of Filing of SR-NASD-99-21 on June 17, 1999. In that filing, NASD Regulation is proposing to create a dispute resolution subsidiary, NASD Dispute Resolution, Inc. ("NASD Dispute Resolution"), to handle dispute resolution programs; to adopt by-laws for such subsidiary; and to make conforming amendments to the Delegation Plan, the NASD Regulation By-Laws, and the Rules of the Association.

The Commission received one comment letter on the proposed rule change, from the Securities Industry Association ("SIA").¹ The SIA commended the NASD for enhancing market efficiencies by creating a separate subsidiary to handle all dispute resolution matters. The SIA raised some concerns, however, which are addressed below.

Composition of the NASD Dispute Resolution Board

The SIA expressed the view that the proposed Board of Directors of NASD Dispute Resolution ("the Board") would not have adequate representation from the securities

¹ Letter from Stephen G. Sneeringer, Chairman of the Arbitration Committee, SIA, to Jonathan G. Katz, Secretary, Commission (July 8, 1999) ("SIA Letter").

industry.² Under the proposal, the majority of the Board (which may consist of five to eight directors) would be non-industry. Using the minimum number of five Board directors as an example, three would be classified as “non-industry” and two would be classified as “industry,” as those terms are defined in the proposed NASD Dispute Resolution By-Laws.³ Of the three non-industry Board directors, at least two also must be Governors on the NASD Board (referred to herein as “interlocking directors”). In the rule description, NASD Regulation indicated that the third non-industry director might be a person knowledgeable in the dispute resolution field, but such a qualification is not required by the By-Laws. At least one of the three non-industry Board directors must also qualify as “public” as defined in the By-Laws.⁴ Such a person might be either a director of the NASD Board or a director who is not on the NASD Board. Of the two Board directors counted as “industry,” one would be a director of the NASD Board and one would be the President of NASD Dispute Resolution.

SIA makes three points with regard to the composition of the Board: (i) industry and non-industry representation should be equal; (ii) it is inappropriate to consider the President of the new subsidiary to be an industry representative; and (iii) the Board may be dominated by claimants’ lawyers. With regard to the first two points, NASD Dispute Resolution’s By-Laws and Board structure are modeled on those of NASD Regulation, which were developed to respond to concerns expressed by the Commission⁵ and the Rudman Committee.⁶ The NASD Regulation By-Laws require the Board to have a majority of non-industry members.⁷ NASD Regulation understands that this formula will be required by the Commission for NASD Dispute Resolution as well. Similarly, the Presidents of both NASD Regulation and Nasdaq are required to be counted with the industry participants in those subsidiaries’ By-Laws for compositional and quorum requirements.⁸

² *Id.* at 3.

³ Article I, Sections (l) and (u).

⁴ Article I, Section (w). Article IV, Section 4.3 also provides that if the Board consists of the maximum number of eight directors, then at least two directors must be classified as public.

⁵ *Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the Nasdaq Market* 4-5, [1996-1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,824, at 88,295 (August 8, 1996). See also note 12 *infra* and accompanying text.

⁶ *Report of the NASD Select Committee on Structure and Governance to the NASD Board of Governors* (September 1995).

⁷ NASD Regulation By-Laws, Article IV, Section 4.3. The Nasdaq Stock Market, Inc. (“Nasdaq”) also requires a majority of non-industry directors on its Board (Nasdaq By-Laws, Article IV, Section 4.3.); and the NASD requires a majority of non-industry Governors on its Board (NASD By-Laws, Article VII, Section 4).

⁸ The Commission discussed these By-Laws provisions in its Order approving the changes, Exchange Act Release No. 39326 (Nov. 14, 1997) (File Nos. SR-NASD-97-71, SR-NASD-96-20, and SR-NASD-96-29),

With regard to the SIA's third point, NASD Regulation does not foresee that the NASD Dispute Resolution Board will be dominated by claimants' lawyers. At least two of the three non-industry directors will come from the NASD Board. As characterized by the SIA in its letter, the current public members of the NASD and NASD Regulation Boards are persons who are "truly neutral or academic individuals" and the other current non-industry members are "senior executives from major corporations with no particular affiliation with, or preconceived biases, about, the securities industry...."⁹ Only one non-industry director may be chosen from outside the NASD Board if the five-member Board is used for NASD Dispute Resolution. No decision has been made as yet as to the identity or occupation of such an individual, although NASD Regulation indicated in its filing that the director should be knowledgeable in the dispute resolution field. As noted in the SIA letter, it is possible that the non-interlocking, non-industry director could be a neutral (arbitrator or mediator) or an academic.¹⁰

Composition of the NAMC

SIA objects to the fact that the National Arbitration and Mediation Committee ("NAMC"), which it incorrectly refers to as a "Board," will be composed of at least 50% non-industry members. SIA expresses the opinion that this means the NAMC will be weighted in favor of claimants' lawyers.¹¹ First, the NAMC will continue to be only a committee, not a Board, and simply will be moved from NASD Regulation to the new subsidiary. Secondly, as explained in the rule filing, the change in NAMC composition from a 50-50 balance between industry and non-industry members to at least 50% percent non-industry members was proposed to provide more flexibility and avoid the possibility of tie votes while maintaining at least 50% non-industry membership. This is in keeping with the first Undertaking contained in the Commission's 1996 Order, which required the NASD:

To implement and maintain at least fifty percent independent public and non-industry membership in its Board of Governors, the Board(s) of Governors or Directors of all of its subsidiaries and affiliates that exercise or have delegated self-regulatory functions, and the . . . Arbitration Committee . . .

62 Fed. Reg. 62385, 62388 and n. 28 (Nov. 21, 1997). See NASD Regulation By-Laws, Article IV, Section 4.3; and Nasdaq By-Laws, Article IV, Section 4.3.

⁹ SIA Letter at 3-4.

¹⁰ Id. at 4.

¹¹ Id.

and all successors thereto.¹²

In practice, NAMC recommendations currently are often made by general consensus rather than formal vote, so significant changes are not expected in the way the NAMC operates; but more importantly, the NAMC's recommendations are only advisory.¹³ Committee and staff recommendations on rule changes or major policy changes must be presented to the NASD Dispute Resolution Board for final approval, as it is the Board that will ultimately manage the property, business, and affairs of NASD Dispute Resolution.¹⁴ In addition, the Delegation Plan provides that actions by the subsidiary Boards are subject to review by the NASD Board.¹⁵

Manner in Which Fees Will Be Imposed

The SIA letter objects to a provision in the Delegation Plan that states, "The NASD Board shall review and ratify a rule change adopted by the NASD Dispute Resolution Board before the rule change becomes the final action of the Association if the rule change: (a) imposes fees or other charges on persons or entities other than NASD members...."¹⁶ This provision incorporates similar language currently contained in the Delegation Plan with regard to actions by the NASD Regulation and Nasdaq Boards.¹⁷ Therefore, the provision is not novel and has not proven to be a problem with regard to the other subsidiaries over the years. In addition, the Delegation Plan states further (as to each of the subsidiaries) that any member of the NASD Board may call an action of the subsidiary for review not later than the NASD Board meeting next following the subsidiary Board's action. This provides a safeguard in case any NASD Board member has questions about, or objections to, an action imposing such fees. Finally, such fee proposals must also be submitted to the Commission for review under Rule 19b-4.¹⁸ These safeguards provide the type of checks and balances

¹² Exchange Act Release No. 37538 (Administrative Proceeding File No. 3-9056), [1996-1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,825, at 88,364 (August 8, 1996).

¹³ Delegation Plan, proposed section V.C.1.

¹⁴ Proposed NASD Dispute Resolution By-Laws, Article IV, Section 4.1.

¹⁵ Delegation Plan, sections II.B.1 and III.B.2, and proposed section V.B.

¹⁶ SIA Letter at 5; see Delegation Plan, proposed new section V.B.

¹⁷ Delegation Plan, sections II.B.1 and III.B.2.

¹⁸ 17 C.F.R. § 240.19b-4. Such proposals are normally effective upon filing under paragraph (f)(2) of Rule 19b-4; however, the Commission publishes such proposals for comment and may abrogate them within 60 days after the date of filing, as provided in Section 19(b)(3)(C) of the Securities Exchange Act of 1934, 15 U.S.C. § 78s(b)(3)(C).

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which the SIA believes are necessary.

Summary

NASD Regulation appreciates the SIA's comments, and feels that the SIA's concerns have been fully addressed. Therefore, NASD Regulation believes the proposed rule change should be approved as submitted.

If you have any questions, please call me at (202) 728-6959; e-mail:
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Very truly yours,

Jean I. Feeney

cc: Mandy Cohen
Sonia Patton