

John M. Ramsay
Vice President and
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August 14, 1998

By Hand

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Mail Stop 10-1

Re: **File No. SR-NASD-98-48, Amendment No. 3**
Proposed Rule Change to Amend the Method of
Selecting Arbitrators in Customer Disputes

Dear Ms. England:

Pursuant to Rule 19b-4, the National Association of Securities Dealers, Inc. ("NASD") and NASD Regulation, Inc. ("NASD Regulation") (collectively, the "Association") file this letter as Amendment No. 3 to SR-NASD-98-48. Also enclosed is a 3 ½" disk containing the rule filing in WordPerfect 6.0 to facilitate production of the Federal Register release.

The Association proposes several clarifying changes to Rule 10308 and Rule 10312. The text of the proposed amendments is set forth in attached Exhibit A. The language proposed in the filing and Amendments Nos. 1 and 2 is treated as adopted; new language proposed in this Amendment No. 3 is underlined and language to be deleted is bracketed. The reasons for the proposed amendments are set forth below.

Rule 10308. In paragraph (a) of proposed Rule 10308, the Association proposes to amend two phrases in the definition of "non-public arbitrator." (Rule 10308(a)(4).) In paragraph (a)(4)(A)(i), the Association proposes to incorporate the standard terminology, "municipal securities dealer," that is used with respect to persons professionally engaged in buying and selling municipal securities. In paragraph (a)(4)(D), the Association proposes to add an explicit reference to government and municipal securities to make clear that employees of banks or other financial institutions

who engage in government or municipal securities transactions (or persons who supervise such persons) are included in the group described in proposed paragraph (a)(4)(D).

In part (b) of proposed Rule 10308, the Association proposes the following changes. First, the Association proposes to make parallel, clarifying amendments to the provisions in paragraph (b)(1) of the rule, which set forth the number and type (public or non-public) of arbitrators to be appointed. In proposed paragraph (b)(1), claims that are for \$50,000 or less (proposed paragraph (b)(1)(A), formerly paragraph (b)(1)(A)(i)) are distinguished from those that are for an amount greater than \$50,000 (proposed paragraph (b)(1)(B), formerly paragraph (b)(1)(A)(ii)). Each of these paragraphs contains a general presumption regarding the appropriate panel composition and provides that the parties may change that composition upon agreement; the Association proposes in this amendment to state more clearly the parties' right to change panel composition.

As a second change, the Association is proposing to reorder proposed paragraph (b)(1) and add one new subparagraph, proposed paragraph (A)(i), for clarification. The proposed amendment to paragraph (b)(1) clarifies that under proposed Rule 10308, certain cases that are for a claim of \$50,000 or less may be arbitrated by a three-person panel rather than by one arbitrator in certain circumstances. For a claim of \$25,000 or less, a single arbitrator already appointed to the case may request that the Director appoint two additional arbitrators. (Proposed new paragraph (b)(1)(A)(i).) For a claim of more than \$25,000 and not more than \$50,000, any party (in its initial filing) or an appointed arbitrator may request that the Director appoint a three-arbitrator panel. (Proposed new paragraph (b)(1)(A)(ii), formerly paragraph (b)(1)(B).) Also, in proposed paragraph (b)(1)(a)(ii) (formerly paragraph (b)(1)(B)), the Association proposes to delete the words, "the claimant," and replace it with the words, "a party," to clarify that either a claimant or a respondent may request a three-arbitrator panel under this subparagraph.

These changes to (b)(1) incorporate the concepts that were approved in amendments to Rule 10308 and Rule 10302, Simplified Arbitration, by the Commission on May 14, 1997 (*see* SR-NASD-97-22, approved in Securities Exchange Act Release No. 38635 (May 14, 1997), 62 FR 27819 (May 21, 1997), but have not yet been made effective for administrative and technical reasons relating to the approval of a related rule amendment concerning filing and forum fees. The Association wishes to retain these provisions in the new Rule 10308. In addition, the Association is proposing to add new paragraph (b)(1)(A)(i) because the Association believes that by explicitly

addressing the two subcategories of cases involving claims of \$50,000 or less, the interaction between proposed Rule 10308 and Rule 10302, Simplified Arbitration, is clearer to the reader.

There are two other changes proposed to paragraph (b). The Association proposes to amend paragraph (b)(4) of proposed Rule 10308 in order to alert parties that the identification of conflicts of interests will be limited at this stage in the process of list selection of arbitrators. At this stage, a conflict of interest will be identified only if it can be done using the Neutral List Selection System database; other, more specific conflicts of interest reviews will be performed in subsequent stages in the list selection process. In paragraph (b)(6), the Association is proposing to clarify that the information about each listed arbitrator that the Director will forward to the parties is employment information for a 10-year period and other background information.

The Association proposes the following three changes to proposed Rule 10308(c). The Association's proposed new list selection rule requires that the parties rank arbitrators by preference, using numerical rankings. The Association has clarified that a ranking of "1" means that the arbitrator is the most preferred (or most highly ranked) arbitrator, by stating this in the rule in proposed changes to paragraphs (c)(1)(B) and (C). Also, in paragraph (c), the Association proposes to delete subparagraph (1)(D), which stated that parties may act cooperatively in ranking arbitrators. Implicitly, parties may act cooperatively to rank arbitrators. The Association proposes to delete the provision because it is unnecessary.

In subparagraph (c)(4)(B) and also in paragraph (d)(3), the Association proposes to clarify the parties' rights when the Director is required in two different circumstances to appoint an arbitrator who is not on the consolidated list. The Director appoints an unlisted arbitrator when there are not enough arbitrators on the consolidated list to create the initial panel (proposed paragraph (c)(4)(B)), or when there are not enough arbitrators remaining on the consolidated list to fill a vacancy on an appointed panel when an arbitrator is disqualified or becomes otherwise unable or unwilling to serve (proposed paragraph (d)(3)). In both paragraphs, the following sentence has been added: "The Director shall provide the parties information about the arbitrator as provided in paragraph (b)(6), and the parties shall have the right to object to the arbitrator as provided in paragraph (d)(1)."

Finally, as the last change to Rule 10308, the Association also proposes to amend paragraph (d)(3) to clarify the procedures that are used when the Director appoints a replacement arbitrator prior to the commencement of the earlier of (i) the first prehearing conference or (ii) the first hearing.

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Rule 10312. The Association proposes to reorder and clarify the information in proposed paragraphs (d), (e), and (f). In paragraph (d), the Association proposes to add the phrase, “prior to the commencement of the earlier of (i) the first prehearing conference or (ii) the first hearing,” to clarify that paragraph (d) applies during that time frame, and to state in that paragraph, rather than in paragraph (e), that the Director has the authority to remove an arbitrator based upon information disclosed under Rule 10312. In paragraph (e), the Association proposes that the Director shall inform the parties of any information disclosed to the Director under the Rule unless either the arbitrator voluntarily withdraws as soon as the arbitrator learns of the disqualifying interest or relationship or the Director removes the arbitrator. This concept was previously addressed in both proposed paragraphs (d) and (e). Finally paragraph (f) is amended to clarify that when an arbitrator serves after the Director’s authority to disqualify ceases, the Director will continue to pass through to the parties information disclosed regarding the arbitrator. Under proposed paragraph (f), the information will continue to flow through to the parties upon disclosure to the Director whether the arbitrator remains on a panel or resigns.

If you have any questions, please contact Sharon Zackula, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8985; e-mail zackulas@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

John M. Ramsay
Vice President and
Deputy General Counsel

Exhibit A

10308. Selection of Arbitrators in Customer Disputes

* * *

(a) Definitions

(1) through (3) No change

(4) “non-public arbitrator”

The term “non-public arbitrator” means a person who is otherwise qualified to serve as an arbitrator and:

(A) is, or within the past three years, was:

(i) associated with a broker or a dealer (including a government securities broker or dealer or a municipal securities [broker or] dealer);

(ii) through (iv) No change

(B) through (C) No change

(D) is an employee of a bank or other financial institution and effects transactions in securities, including government or municipal securities, and commodities futures or options or supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities.

(5) through (7) No change

(b) Composition of Arbitration Panel; Preparation of Lists for Mailing to Parties

(1) Composition of Arbitration Panel

(A) Claims of \$50,000 or Less [General Rule Regarding Panel Composition] [(i)]

If the amount of a claim is \$50,000 or less, the Director shall appoint an arbitration panel composed of one public arbitrator, unless the parties agree [otherwise]to the appointment of a non-public arbitrator.

(i) If the amount of a claim is \$25,000 or less and an arbitrator appointed to the case requests that a panel of three arbitrators be appointed, the Director shall appoint an arbitration panel composed of one non-public arbitrator and two public arbitrators, unless the parties agree to a different panel composition.

(ii) If the amount of a claim is greater than \$25,000 and not more than \$50,000 and a party in its initial filing or an arbitrator appointed to the case requests that a panel of three arbitrators be appointed, the Director shall appoint an arbitration panel composed of one non-public arbitrator and two public arbitrators, unless the parties agree to a different panel composition.

[(ii) If the amount of a claim is more than \$50,000, the Director shall appoint an arbitration panel composed of one non-public arbitrator and two public arbitrators, unless the parties agree otherwise.]

(B) [Special Request] Claims of More than \$50,000

If the amount of a claim is more than \$50,000, the Director shall appoint an arbitration panel composed of one non-public arbitrator and two public arbitrators, unless the parties agree to a different panel composition.

[If the amount of a claim is greater than \$25,000 and not more than \$50,000 and the claimant requests that a panel of three arbitrators be appointed, the Director shall appoint an arbitration panel composed of one non-public arbitrator and two public arbitrators, unless the parties agree otherwise.]

(2) through (3) No change

(4) Preparation of Lists

(A) Except as provided in subparagraph (B) below, the Neutral List Selection System shall generate the lists of public and non-public arbitrators on a rotating basis within a designated geographic hearing site and shall exclude arbitrators based upon conflicts of interest identified within the Neutral List Selection System database.

(B) No change

(5) No change

(6) Information About Arbitrators

The Director shall send to the parties employment history for each listed arbitrator for the past 10 years and [any] other background information [disclosed by the arbitrator under Rule 10312 relating to personal or financial interests or the existence of a relationship that gives rise to an appearance of a conflict of interest or bias]. If a party requests additional information about an arbitrator, the Director shall send such request to the arbitrator, and shall send the arbitrator's response to all parties at the same time. When a party requests additional information, the Director may, but is not required to, toll the time for the parties to return the ranked lists under paragraph (c)(2).

(c) Striking, Ranking, and Appointing Arbitrators on Lists

(1) Striking and Ranking Arbitrators

(A) No change

(B) Ranking - Panel of One Arbitrator

Each party shall rank all of the arbitrators remaining on the list by assigning each arbitrator a different, sequential, numerical ranking, with a "1" rank indicating the party's first choice, a "2" indicating the party's second choice, and so on.

(C) Ranking - Panel of Three Arbitrators

Each party shall rank all of the public arbitrators remaining on the list by assigning each arbitrator a different, sequential, numerical ranking, with a "1" rank indicating the party's first choice, a "2"

indicating the party's second choice, and so on. Each party [and]
separately shall rank all of the non-public arbitrators remaining on the
list, using the same procedure.

[(D) Joint Action Permitted

All claimants may act jointly and all respondents, including third-party respondents, may act jointly to file a single list that reflects their unanimous agreement as to the striking and ranking of arbitrators. If multiple claimants or respondents do not act jointly, the rankings of multiple claimants or respondents will be consolidated as described in paragraph (b)(3)(A).]

(2) through (3) No change

(4) Appointment of Arbitrators

(A) No change

(B) Discretion to Appoint Arbitrators Not on List

If the number of arbitrators available to serve from the consolidated list is not sufficient to fill a panel, the Director shall appoint one or more arbitrators to complete the arbitration panel. *[; provided, however,]* Unless the parties agree otherwise, the Director may not appoint a non-public arbitrator under paragraphs (a)(4)(B) or (a)(4)(C). The Director shall provide the parties information about the arbitrator as provided in paragraph (b)(6), and the parties shall have the right to object to the arbitrator as provided in paragraph (d)(1).

(5) through (6) **No change**

**(d) Disqualification and Removal of Arbitrator Due to Conflict of Interest
or Bias**

(1) through (2) **No change**

(3) Vacancies Created by Disqualification or Resignation

Prior to the commencement of the earlier of (i) the first prehearing conference or (ii) the first hearing, [I]f an arbitrator appointed to an arbitration panel is disqualified or is otherwise unable or unwilling to serve, [resigns from an arbitration panel,] the Director shall appoint from the consolidated list of arbitrators the arbitrator who is the most highly ranked available arbitrator of the proper classification remaining on the list. If there are no available arbitrators of the proper classification on the consolidated list, the Director shall appoint an arbitrator of the proper classification subject to the limitation set forth in paragraph (c)(4)(B). The Director shall provide the parties information about the arbitrator as provided in paragraph (b)(6), and the parties shall have the right to object to the arbitrator as provided in paragraph (d)(1).

(e) No change

* * *

**Rule 10312. Disclosures Required of Arbitrators and Director's Authority To
Disqualify**

(a) through (c) **No change**

* * *

(d) Prior to the commencement of the earlier of (i) the first prehearing conference or (ii) the first hearing, the Director may remove an arbitrator based on information disclosed pursuant to this Rule.

(e) Prior to the commencement of the earlier of (i) the first prehearing conference or (ii) the first hearing, t[T]he Director shall inform the parties to an arbitration proceeding of any information disclosed to the Director under this Rule unless either the arbitrator who disclosed the information withdraws [from being considered for appointment] voluntarily as soon as [and immediately after] the arbitrator learns of any interest or relationship described in paragraph (a) that might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, or the Director removes the arbitrator.

[(e) Prior to the commencement of the earlier of (i) the first prehearing conference or (ii) the first hearing, the Director may remove an arbitrator based on information disclosed pursuant to this Rule.]

(f) After the commencement of the earlier of (i) the first prehearing conference or (ii) the first hearing, the Director's authority to remove an arbitrator from an arbitration panel ceases. During this period, the Director shall inform the parties of any information disclosed by an arbitrator under this Rule.

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