

August 4, 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: File No. SR-NASD-2003-122 - Proposal to Conduct Background Verification and Charge  
Application Fee for NASD Neutral Roster Applicants

Dear Ms. Harmon:

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 Jean I. Feeney, NASD Dispute Resolution, at (202) 728-6959; e-mail [jean.feeney@nasd.com](mailto:jean.feeney@nasd.com). The fax number is (202) 728-8833.

Very truly yours,

Barbara Z. Sweeney  
Senior Vice President  
and Corporate Secretary

Enclosures

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C.

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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”), 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 conduct background verification and charge an application fee for NASD neutral roster applicants. NASD is not proposing any textual changes to the By-Laws or Rules of NASD.

(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 April 23, 2003, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Regulation 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 had an opportunity to review the proposed rule change at its meeting on April 24, 2003. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(iii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to issue orders and interpretations without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be the first business day of the first month immediately following Commission approval.

(b) Questions regarding this rule filing may be directed to Jean I. Feeney, NASD Dispute Resolution at (202) 728-6959; e-mail [jean.feeney@nasd.com](mailto:jean.feeney@nasd.com).

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

(a) Purpose

NASD Dispute Resolution proposes to begin conducting background verifications of all new arbitrator applicants, and to assess an application fee to cover the cost of the verifications.

**Background**

NASD maintains a pool of approximately 7000 available arbitrators. Currently, arbitrator applicants submit biographical profile forms, together with two letters of reference. The biographical profile forms require applicants to provide detailed information on their business and employment histories, education, training, possible conflicts, experience, expertise, associations with industry members, and other matters. The application also requires a narrative background information statement in which applicants are asked to explain why they believe their experience and knowledge would benefit the process. Attorneys and accountants are further directed to provide specific details about their practices. A copy of the current NASD arbitrator application is attached as Exhibit 2.

Arbitrator information is entered into NASD's database and is provided to parties in the form of a disclosure report during the arbitrator selection process. Arbitrators must update this biographical information on a regular basis. NASD sends frequent reminders to arbitrators about

the importance of this obligation, especially after they are notified regarding possible service as an arbitrator. NASD requires arbitrators in each case to affirm that they have reviewed their disclosure report and that it is accurate, and to complete a disclosure checklist attached to the oath. NASD provides each arbitrator on a panel with the co-panelists' biographical profiles in order to facilitate peer reviews for accuracy.<sup>1</sup>

In addition to gathering the above information, NASD currently checks records on the Central Registration Depository (CRD) for arbitrator applicants who have been registered with NASD, most of whom would be categorized as "non-public" arbitrators under NASD Rule 10308(a)(4). NASD currently does not verify any of the information provided by arbitrator applicants who do not have CRD records, most of whom would be classified as "public" arbitrators under NASD Rule 10308(a)(5).

### **Proposed Rule Change**

NASD proposes to expand its verification of background information to cover all arbitrator applicants. This will provide additional protection to parties using the Dispute Resolution forum, raise the standards of the neutral roster, and enhance investor confidence in the integrity of the forum.

Specifically, NASD Dispute Resolution has identified a vendor to provide the following verification services:

- Criminal check in the county of the applicant's residence;
- Federal criminal check;

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<sup>1</sup> For additional information on procedures designed to reveal potential conflicts of interest, see Professor Michael A. Perino, Report to the SEC Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations (Nov. 12, 2002), available on the Commission's Website, Market Regulation page, at: <http://www.sec.gov/pdf/arbconflict.pdf>.

- Employment verification; and
- Professional license verification.

The verification fee will be \$80.00 per application. This fee will cover the vendor's expected charge for verification of each application, with the understanding that the actual work required to verify each application will vary. For example, some applicants will have only one employer over the past ten years, and some will have two or more. NASD believes that having a single, reasonable fee for background verification will be more practical administratively than charging different fees that vary depending on each applicant's background. For this amount, the vendor will perform county and federal criminal record checks; verify any professional licenses; and check the last employer or, if the applicant has been employed for fewer than ten years by the same employer, then the last two employers. To keep the fee reasonable, NASD will assume that verification of professional licenses provides an indirect check on the applicant's education, since licensing authorities generally verify an applicant's educational history. If the applicant does not have a professional license, however, then the vendor will substitute verification of the last degree awarded.

The background verification fee will be charged for new arbitrator applications that are received by NASD after the effective date of the proposed rule change. It will not apply to arbitrators currently on NASD's arbitrator roster who wish to update information they supplied previously. Applications received after the effective date will not be processed until NASD receives the proper fee.

(b) Statutory Basis

NASD Dispute Resolution 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 NASD'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 verifying background information and credentials for arbitrator applicants will protect investors and the general public and enhance the integrity of the arbitration process. 4.

Self-Regulatory Organization's Statement on Burden on Competition

NASD Dispute Resolution 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 Dispute Resolution 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)

NASD requests the Commission to shorten the public comment period and to approve this rule filing on an accelerated basis to permit NASD to begin conducting background verifications and to charge an application fee. Because the proposed rule change applies to prospective arbitrator applicants only, the rule change will have no adverse impact on parties or arbitrators in

ongoing arbitrations, and NASD believes it is appropriate to begin conducting background verifications as soon as possible. Accordingly, NASD requests the Commission to find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after its publication in the Federal Register.

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

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.
2. Current arbitrator application form.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Dispute Resolution 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: August 4, 2003

## SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-122)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Proposal to Conduct Background Verification and Charge Application Fee for NASD Neutral Roster Applicants

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> 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. 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 Dispute Resolution is proposing to conduct background verification and charge an application fee for NASD neutral roster applicants. NASD is not proposing any textual changes to the By-Laws or Rules of NASD.

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 Dispute Resolution 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

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

places specified in Item IV below. NASD Dispute Resolution 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

NASD Dispute Resolution proposes to begin conducting background verifications of all new arbitrator applicants, and to assess an application fee to cover the cost of the verifications.

**Background**

NASD maintains a pool of approximately 7000 available arbitrators. Currently, arbitrator applicants submit biographical profile forms, together with two letters of reference. The biographical profile forms require applicants to provide detailed information on their business and employment histories, education, training, possible conflicts, experience, expertise, associations with industry members, and other matters. The application also requires a narrative background information statement in which applicants are asked to explain why they believe their experience and knowledge would benefit the process. Attorneys and accountants are further directed to provide specific details about their practices. A copy of the current NASD arbitrator application is attached as Exhibit 2.

Arbitrator information is entered into NASD's database and is provided to parties in the form of a disclosure report during the arbitrator selection process. Arbitrators must update this biographical information on a regular basis. NASD sends frequent reminders to arbitrators about the importance of this obligation, especially after they are notified regarding possible service as an arbitrator. NASD requires arbitrators in each case to affirm that they have reviewed their disclosure report and that it is accurate, and to complete a disclosure checklist attached to the

oath. NASD provides each arbitrator on a panel with the co-panelists' biographical profiles in order to facilitate peer reviews for accuracy.<sup>3</sup>

In addition to gathering the above information, NASD currently checks records on the Central Registration Depository (CRD) for arbitrator applicants who have been registered with NASD, most of whom would be categorized as "non-public" arbitrators under NASD Rule 10308(a)(4). NASD currently does not verify any of the information provided by arbitrator applicants who do not have CRD records, most of whom would be classified as "public" arbitrators under NASD Rule 10308(a)(5).

### **Proposed Rule Change**

NASD proposes to expand its verification of background information to cover all arbitrator applicants. This will provide additional protection to parties using the Dispute Resolution forum, raise the standards of the neutral roster, and enhance investor confidence in the integrity of the forum.

Specifically, NASD Dispute Resolution has identified a vendor to provide the following verification services:

- Criminal check in the county of the applicant's residence;
- Federal criminal check;
- Employment verification; and
- Professional license verification.

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<sup>3</sup> For additional information on procedures designed to reveal potential conflicts of interest, see Professor Michael A. Perino, Report to the SEC Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations (Nov. 12, 2002), available on the Commission's Website, Market Regulation page, at: <http://www.sec.gov/pdf/arbconflict.pdf>.

The verification fee will be \$80.00 per application. This fee will cover the vendor's expected charge for verification of each application, with the understanding that the actual work required to verify each application will vary. For example, some applicants will have only one employer over the past ten years, and some will have two or more. NASD believes that having a single, reasonable fee for background verification will be more practical administratively than charging different fees that vary depending on each applicant's background. For this amount, the vendor will perform county and federal criminal record checks; verify any professional licenses; and check the last employer or, if the applicant has been employed for fewer than ten years by the same employer, then the last two employers. To keep the fee reasonable, NASD will assume that verification of professional licenses provides an indirect check on the applicant's education, since licensing authorities generally verify an applicant's educational history. If the applicant does not have a professional license, however, then the vendor will substitute verification of the last degree awarded.

The background verification fee will be charged for new arbitrator applications that are received by NASD after the effective date of the proposed rule change. It will not apply to arbitrators currently on NASD's arbitrator roster who wish to update information they supplied previously. Applications received after the effective date will not be processed until NASD receives the proper fee.

(b) Statutory Basis

NASD Dispute Resolution 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 NASD'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 verifying background information and credentials for arbitrator applicants will protect investors and the general public and enhance the integrity of the arbitration process.

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

NASD Dispute Resolution 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 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 Dispute Resolution has requested that the Commission shorten the time period for public comment to 15 days and find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in particular, the requirements of Section 15A and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will benefit investors and other users of the NASD arbitration forum. Because the proposed rule change will apply to prospective arbitrator applicants only, the rule change will have no adverse impact on parties or arbitrators in ongoing arbitrations.

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

#### 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 15 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