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February 2, 2004

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-2003-95 - Amendments to Rules 10308 and 10312 of the NASD Code of Arbitration Procedure Governing Arbitrator Classification – Second Response to Comments

Dear Ms. Harmon:

The above-referenced rule filing was filed on June 12, 2003 and published for comment on August 21, 2003. The public comment period ended September 11, 2003. NASD responded to comments on September 30, 2003. On January 22, 2004, staff of the Securities and Exchange Commission ("SEC") requested that NASD respond to three additional comment letters received by the SEC after the period for public comment had expired, and after NASD had filed its Response to Comments.

The proposed rule change would amend Rules 10308 and 10312 of the NASD Code of Arbitration Procedure ("Code"), which govern the classification of arbitrators, to further ensure that parties who have, or who are reasonably perceived to have, significant ties to the securities industry cannot serve as public arbitrators, even if those ties are indirect. Many of the proposed amendments are in response to recommendations contained in Professor Michael Perino's Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitration (Perino Report)[1].

[1] As NASD noted in its earlier response, the SEC commissioned the Perino Report in July 2002 to assess the adequacy of NASD (and New York Stock Exchange) arbitrator disclosure requirements, and to evaluate the impact of the recently adopted California Ethics Standards on the current conflict disclosure rules of the self-regulatory organizations (SROs). (See "Ethics Standards for Neutral Arbitrators in Contractual Arbitration," California Rules of Court, Division VI of the Appendix.) The Perino Report, issued in November 2002, concluded that undisclosed conflicts of interest were not a significant problem in SRO-sponsored arbitrations. However, the Perino Report recommended several amendments to SRO arbitrator classification and disclosure rules that, according to the Report, might "provide additional assurance to investors that arbitrations are in fact neutral and fair."

The late comment letters raise similar, if not identical, issues to the comments addressed in NASD's original Response to Comments. One commenter, Mr. James Dolan, objects to the proposed expansion of the definition of "immediate family member" in Rule 10308(a)(5)(A) to include parents, stepparents, children and stepchildren. Another commenter, Mr. Richard Ryder, objects to the proposed amendment to Rule 10308(a)(5)(A)(iv) to exclude from the definition of public arbitrator any "attorney, accountant, or other professional whose firm derived ten percent or more of its annual revenue in the past 2 years" from any persons or entities involved in the securities industry." Both Mr. Dolan and Mr. Ryder argue that these amendments would arbitrarily exclude persons who have no actual or empirically demonstrable bias in favor of the securities industry from serving as public arbitrators, are not supported by clear evidence that such persons are actually biased in favor of the industry, and would limit the depth of the NASD arbitrator pool.

As NASD stated in its previous response, the proposed rule change is not "intended to eliminate only persons with actual bias, but also persons who could reasonably perceive to be biased." In his report, Professor Perino observed that "no classification rule could ever precisely define public and non-public arbitrators; there will always be classification questions at the margins about which reasonable people will differ." Given the inherently imprecise nature of such definitions, NASD believes that, to protect both the integrity of the NASD forum, and investors' confidence in the integrity of the forum, it is preferable that the definition of public arbitrator be overly restrictive rather than overly permissive. NASD believes that both the amendments to the definition of the term "immediate family member" and the "ten percent of annual revenues" threshold will help eliminate the potential perception of bias, despite the fact that any given individual who falls within that category may not in fact be biased.

NASD also disagrees with the suggestion that either of these provisions would significantly impact the depth of the NASD public arbitrator pool. As it stated in its previous response, NASD took this concern into account before filing the proposed rule change, and has concluded that the amendments, if approved, will not adversely impact its ability to panel cases.

NASD also respectfully disagrees with Mr. Dolan's assertion that the proposed expansion of the term "immediate family member" constitutes a "radical departure" from, or conflicts with, either its own disclosure practice, or with the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes, both of which require arbitrators to disclose the existence of interests or relationships that are likely to affect their impartiality or might reasonably create an appearance that they are biased against one party or favorable to another. The definition of "immediate family member" relates to whether an arbitrator should be classified as public or non-public, for purposes of providing the appropriate panel composition required under NASD rules. The case-specific disclosure requirements referenced by Mr. Dolan, on the other hand, address what relationships and circumstances all arbitrators, both public and non-public, must disclose once they have been appointed to

the panel in a particular dispute. Therefore, the proposed rule change and the existing disclosure requirements do not conflict at all, and are in fact complementary.[2]

Mr. Ryder also questions why NASD's proposal regarding revenue thresholds differs from the provision adopted by the Securities Industry Conference on Arbitration ("SICA"), which would impose a 20% threshold. NASD has carefully considered SICA's proposal. However, both the Board of Directors of NASD Dispute Resolution, Inc., and its National Arbitration and Mediation Committee, have concluded that the proposed rule change would best protect the integrity of the NASD forum from both the reality and the perception of impartiality.

Finally, without specifically referencing or commenting on the proposed rule change, the third commenter, Mr. Seth Lipner, suggests that NASD should bar persons with ties to banks or related institutions from serving as public arbitrators. While NASD takes note of the suggestion, NASD notes that it is outside the scope of the present rule change.

NASD believes that the proposed rule change is in the public interest. By providing further assurance to parties that individuals with significant ties to the securities industry are not able to serve as public arbitrators in NASD arbitrations, the proposed rule change will enhance investor confidence in the fairness and neutrality of NASD's arbitration forum. For these reasons, NASD urges the Commission to approve this rule filing.

If you have any questions, please contact me at (202) 728-8275 or laura.gansler@nasd.com.

Very truly yours,

Laura Gansler
Counsel

[2] To the extent Mr. Dolan is suggesting that NASD eliminate the distinction between public and non-public arbitrators, NASD believes that the classification of arbitrators on its roster as either public or non-public is fundamental to its ability to provide a fair, transparent forum for all parties. NASD also notes that the Perino Report recommended sharpening, rather than eliminating, the distinctions between public and non-public arbitrators.