

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2004 - 164
Amendment No. 1

Proposed Rule Change by National Association of Securities Dealers
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial ☐	Amendment ☒	Withdrawal ☐	Section 19(b)(2) ☒	Section 19(b)(3)(A) ☐	Section 19(b)(3)(B) ☐
			Rule		
Pilot ☐	Extension of Time Period for Commission Action ☐	Date Expires 	☐ 19b-4(f)(1) ☐ 19b-4(f)(2) ☐ 19b-4(f)(3)	☐ 19b-4(f)(4) ☐ 19b-4(f)(5) ☐ 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document
☐

Exhibit 3 Sent As Paper Document
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Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Mignon Last Name McLemore
Title Counsel
E-mail mignon.mclemore@nasd.com
Telephone (202) 728-8151 Fax (202) 728-8833

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 01/05/2005

By Jean I. Feeney
(Name)

Vice President and Chief Counsel, Dispute Resolution

(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Jean Feeney, jean.feeney@nasd.com

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

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” or “Association”), 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 amend Rule 10308 of the NASD Code of Arbitration Procedure (“Code”) to change the method used by the Neutral List Selection System to select arbitrators from rotational to random, as proposed in the pending Customer and Industry Code revisions.¹ Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * *

10308. Selection of Arbitrators

This Rule specifies how parties may select or reject arbitrators, and who can be a public arbitrator.

(a) Unchanged.

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

Parties

(1) – (3) Unchanged.

(4) Preparation of Lists

¹ NASD Dispute Resolution has filed with the SEC a proposed rule change to the Code to reorganize the current rules, simplify the language, codify current practices, and implement several substantive changes. The rule filing was submitted in three parts: Customer Code, Industry Code, and Mediation Code. The Customer Code was filed on October 15, 2003, and amended on January 3, 2005 (SR-NASD-2003-158); the Industry Code was filed on January 16, 2004, and amended on February 26, 2004 and on January 3, 2005 (SR-NASD-2004-011). The Mediation Code was filed on January 23, 2004, and amended on January 3, 2005 (SR-NASD-2004-013). The provision modifying how the Neutral List Selection System (NLSS) selects arbitrators is the same in the proposed Customer and Industry revisions. The Mediation revision does not contain any provisions concerning NLSS. The Code revision is undergoing SEC staff review and has not yet been published for comment.

(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] random 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) Unchanged.

(5) – (6) Unchanged.

(c) – (f) Unchanged.

* * *

(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 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 NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

The proposed rule change will become effective upon Commission approval. However, it will not become operational until the third quarter of 2005. Upon Commission approval, NASD programmers will begin developing the software to adapt

the random selection function to the MATRICS² Computer Project (“MATRICS”), a new computer system being designed and created for NASD Dispute Resolution, which will replace its two case management systems. During this time, the Neutral List Selection System (“NLSS”)³ will continue to generate lists of arbitrators on a rotational basis. Once the software has been developed, it will be added to the arbitrator selection function of MATRICS, which NASD is scheduled to complete in the third quarter of 2005. After the random selection function has been added to MATRICS, arbitrator lists can be generated using random selection. At that point, the proposed rule change can become operational and NASD will announce the effective date in a Notice to Members, which will be published no later than 30 days prior to the time when the random selection function of MATRICS will become operational.

(b) Questions regarding this rule filing may be directed to Mignon McLemore, Counsel, NASD Dispute Resolution, at (202) 728-8151.

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

(a) Purpose

NASD Dispute Resolution is upgrading its computer technology, in what is known as MATRICS, which will replace its two case management systems: CRAFTIS⁴ and NLSS. NASD will implement MATRICS in a series of releases, in which various functions from CRAFTIS and NLSS will be adapted and programmed to operate within

² MATRICS stands for Mediation and Arbitration Tracking and Retrieval Interactive Case System.

³ NLSS stands for the Neutral List Selection System, which is the computer program NASD uses to select arbitrators on a rotational basis. It has been in use since November 1998.

⁴ CRAFTIS is the legacy software application that NASD Dispute Resolution uses to support its case administration function. It uses an old technology platform and is not Web-based.

MATRICS.⁵ NASD has determined that the NLSS components of MATRICS are ready to be developed. Most functions of NLSS will be transferred to MATRICS. However, NASD has determined that MATRICS should select arbitrators on a random basis, instead of a rotational basis, like NLSS currently does.

NASD is proposing to switch from rotational to random for several reasons. First, other self-regulatory organizations, governmental entities, and private alternative dispute organizations select panels for their arbitration cases by generating a random list of arbitrators. For example, the New York Stock Exchange (NYSE)⁶ and the Society of Maritime Arbitrators⁷ offer to the parties a random list selection procedure to select panels to decide claims in their respective arbitration forums. The California Department of Industrial Relations,⁸ the Federal Mediation and Conciliation Service,⁹ and the Federal Emergency Management Agency¹⁰ also use random list selection. Some state courts that

⁵ A new component for MATRICS, the Web-based arbitration claim filing system, has already been developed and became effective on August 5, 2004. Parties may access the online system at http://www.nasdaq.com/online_filing.asp. The SEC approved the final version of the system on June 16, 2004. *See* Securities Exchange Act Rel. No. 34-49876 (June 16, 2004), 69 FR 35090 (June 23, 2004).

⁶ The NYSE filed with the SEC for immediate effectiveness, a request to extend its pilot program, the Voluntary Supplemental Procedures for Selecting Arbitrators ("Voluntary Procedures"), which allows parties to, among other things, select arbitrators using the Random List Selection method. NYSE has also filed a proposal with the SEC to make a variation of the Voluntary Procedures permanent. *See* Information Memo Number 04-36 (July 6, 2004).

⁷ Society of Maritime Arbitrators, Inc., Recreational and Small Commercial Vessel Salvage Arbitration (visited Sept. 29, 2004) <<http://www.smany.org/sma/salvrule.html>>.

⁸ California Department of Industrial Relations, State Mediation and Conciliation Services, *How to Request an Arbitration List* (visited Sept. 1, 2004) <<http://www.dir.ca.gov/csmcs/HowToRequestPanel.html>>.

⁹ Federal Mediation and Conciliation Service, *Arbitration FAQs* (visited Sept. 1, 2004) <<http://www.fmcs.gov/internet/faq.asp?categoryID=133>>.

¹⁰ Federal Emergency Management Agency, *Arbitration Guidelines For The Cerro Grande Fires* (visited Sept. 1, 2004) <<http://www.fema.gov/cerrogrande/arbitration/guide.shtm>>.

provide alternative dispute resolution services also use random list selection to choose arbitrators for their hearings.¹¹

Second, in order for a rotational system to operate effectively and efficiently, a large amount of computer code is required to manage and maintain the arbitrator rotation. A rotational selection system works best if the data that the system uses to generate the lists remain static. However, the data input into NLSS changes frequently. For example, in the last two years, NASD Dispute Resolution has added eight hearing locations, and, in that time, has added approximately 1,000 new arbitrators to the database. Once these changes to the data are input into NLSS, the rotational system attempts to incorporate them when it generates new lists. Any attempt to modify the computer code to accommodate these changes is time-consuming and costly. Also, maintaining a selection system that is purely rotational is cumbersome, because additional code is needed to track the histories of each selection to ensure that all arbitrators have an equal opportunity to appear in the rotation, which directly affects list selection.

Last, NASD understands that, under a random selection system, it is possible for a particular arbitrator to be selected for consecutive lists more frequently than another arbitrator. However, a statistical comparison of one arbitrator's selection to another, using a large sample of eligible arbitrators and lists generated, should show that one arbitrator is not being selected for lists more frequently than any other.¹² While NASD acknowledges this anomaly in a random selection system, NASD believes that the benefits of such a system, such as ease of design, cost-efficient maintenance, and overall

¹¹ See, e.g., U.S. Bankruptcy Court for the Middle District of Tenn. (ADR Program); Minn. Rule 5530.0900; and Nevada Arbitration Rule 6.

¹² In fact, the same comparative analysis conducted under a rotational method should yield a statistically similar result.

fairness of random selection (as well as the increased perception of fairness) will strengthen the operation of the forum.

NASD Dispute Resolution believes that the proposed rule change ultimately will protect investors and benefit the public by providing parties and arbitrators with an automated system, MATRICS, which will help the forum operate more efficiently while maintaining the core goal of providing arbitrators who have an equal probability of being listed for service on any given list of proposed arbitrators. In an effort to sustain the progress made on the MATRICS upgrades, NASD proposes to amend Rule 10308(b)(4) with a delayed implementation date, so that the developers can program this component for MATRICS using the random selection method of generating arbitrator lists in order to be ready when this phase of MATRICS becomes operational. NASD is, therefore, requesting accelerated review and approval for this proposed rule change to allow the programmers to begin creating the code, so that they will remain on development schedule while the Commission is reviewing the Code revisions.¹³ According to the technology development plan, NASD is scheduled to complete the arbitrator selection function of MATRICS in the third quarter of 2005. For the developers to meet this goal, NASD must amend the rule now to introduce the concept of random selection in order to provide the developers with the lead-time necessary to create the software and implement it on the MATRICS platform.¹⁴ While the software is being created, NLSS will continue to generate lists of arbitrators on a rotating basis. Subject to Commission approval of this

¹³ The proposed Customer Code and Industry Code revisions, which have already been filed with the SEC, contain a random selection provision. See note 1 above.

rule, NASD will upgrade MATRICS with the random selection function, phase out NLSS, and replace it with MATRICS.

(b) Statutory Basis

NASD 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 the Association'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 Dispute Resolution believes that the proposed rule change ultimately will protect investors and benefit the public by providing parties with an automated system that will help the forum operate more efficiently.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD 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 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.

¹⁴ The alternative would result in duplicative effort and wasted resources, because programmers would have to develop and program MATRICS to select arbitrators under the current rules, and then discard that programming and create new software once the Code revision has been approved.

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 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. NASD believes that good cause exists to accelerate approval of the proposed rule change, because NASD Dispute Resolution has reached a critical stage in the upgrade of its computer technology platform. One of the most significant aspects of MATRICS will be its ability to generate lists of arbitrators. NASD Dispute Resolution believes that developing and programming a random selection function for MATRICS is the most significant component in this process because it will lay the foundation for future NLSS functions that are adapted for MATRICS. Therefore, as future releases are contingent upon the successful implementation of the random selection function, NASD Dispute Resolution believes that accelerated review and approval will allow the upgrades to continue as scheduled. Moreover, NASD Dispute Resolution believes that the proposed rule change ultimately will protect investors and benefit the public by providing parties with an automated case management system that will help the forum operate more efficiently.

Because NASD believes that the proposed rule change will protect investors and the public interest, NASD requests the Commission to accelerate the effectiveness of 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.

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- _____; File No. SR-NASD-2004-164)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Random Selection of Arbitrators by the Neutral List Selection System

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that 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”) on October 27, 2004 and amended on January 5, 2005,³ the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Dispute Resolution is proposing to amend Rule 10308 of the NASD Code of Arbitration Procedure (“Code”) to change the method used by the Neutral List Selection System to select arbitrators from rotational to random by incorporating the random selection provision of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 to SR-NASD-2004-164 clarifies the purpose of the proposed rule change.

the proposed Customer and Industry Code revisions.⁴ Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * *

10308. Selection of Arbitrators

This Rule specifies how parties may select or reject arbitrators, and who can be a public arbitrator.

(a) Unchanged.

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

(1) – (3) Unchanged.

(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] random 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) Unchanged.

(5) – (6) Unchanged.

(c) – (f) Unchanged.

* * *

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 included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed

⁴ NASD Dispute Resolution has filed with the SEC a proposed rule change to the Code to reorganize the current rules, simplify the language, codify current practices, and implement several substantive changes. The rule filing was submitted in three parts: Customer Code, Industry Code, and Mediation Code. The Customer Code was filed on October 15, 2003, and amended on January 3, 2005 (SR-NASD-2003-158); the Industry Code was filed on January 16, 2004, and amended on February 26, 2004 and on January 3, 2005 (SR-NASD-2004-011). The Mediation Code was filed on January 23, 2004, and amended on January 3, 2005 (SR-NASD-2004-013). The provision modifying how the Neutral List Selection System (NLSS) selects arbitrators is the same in the proposed Customer and Industry revisions. The Mediation revision does not contain any provisions concerning NLSS. The Code revision is undergoing SEC staff review and has not yet been published for comment.

rule change. The text of these statements may be examined at the places specified in Item IV below. NASD 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 is upgrading its computer technology, in what is known as MATRICS, which will replace its two case management systems: CRAFTIS⁵ and NLSS. NASD will implement MATRICS in a series of releases, in which various functions from CRAFTIS and NLSS will be adapted and programmed to operate within MATRICS.⁶ NASD has determined that the NLSS components of MATRICS are ready to be developed. Most functions of NLSS will be transferred to MATRICS. However, NASD has determined that MATRICS should select arbitrators on a random basis, instead of a rotational basis, like NLSS currently does.

NASD is proposing to switch from rotational to random for several reasons. First, other self-regulatory organizations, governmental entities, and private alternative dispute organizations select panels for their arbitration cases by generating a random list of arbitrators. For example, the New York Stock Exchange (NYSE)⁷ and the Society of Maritime Arbitrators⁸ offer to the parties a random list selection procedure to select panels to decide claims in their respective

⁵ CRAFTIS is the legacy software application that NASD Dispute Resolution uses to support its case administration function. It uses an old technology platform and is not Web-based.

⁶ A new component for MATRICS, the Web-based arbitration claim filing system, has already been developed and became effective on August 5, 2004. Parties may access the online system at http://www.nasdaq.com/online_filing.asp. The SEC approved the final version of the system on June 16, 2004. See Securities Exchange Act Rel. No. 34-49876 (June 16, 2004), 69 FR 35090 (June 23, 2004).

⁷ The NYSE filed with the SEC for immediate effectiveness, a request to extend its pilot program, the Voluntary Supplemental Procedures for Selecting Arbitrators ("Voluntary Procedures"), which allows parties to, among other things, select arbitrators using the Random List Selection method. NYSE has also filed a proposal with the SEC to make a variation of the Voluntary Procedures permanent. See Information Memo Number 04-36 (July 6, 2004).

⁸ Society of Maritime Arbitrators, Inc., Recreational and Small Commercial Vessel Salvage Arbitration (visited Sept. 29, 2004) <<http://www.smany.org/sma/salvrule.html>>.

arbitration forums. The California Department of Industrial Relations,⁹ the Federal Mediation and Conciliation Service,¹⁰ and the Federal Emergency Management Agency¹¹ also use random list selection. Some state courts that provide alternative dispute resolution services also use random list selection to choose arbitrators for their hearings.¹²

Second, in order for a rotational system to operate effectively and efficiently, a large amount of computer code is required to manage and maintain the arbitrator rotation. A rotational selection system works best if the data that the system uses to generate the lists remain static. However, the data input into NLSS changes frequently. For example, in the last two years, NASD Dispute Resolution has added eight hearing locations, and, in that time, has added approximately 1,000 new arbitrators to the database. Once these changes to the data are input into NLSS, the rotational system attempts to incorporate them when it generates new lists. Any attempt to modify the computer code to accommodate these changes is time-consuming and costly. Also, maintaining a selection system that is purely rotational is cumbersome, because additional code is needed to track the histories of each selection to ensure that all arbitrators have an equal opportunity to appear in the rotation, which directly affects list selection.

Last, NASD understands that, under a random selection system, it is possible for a particular arbitrator to be selected for consecutive lists more frequently than another arbitrator. However, a statistical comparison of one arbitrator's selection to another, using a large sample of eligible arbitrators and lists generated, should show that one arbitrator is not being selected for

⁹ California Department of Industrial Relations, State Mediation and Conciliation Services, *How to Request an Arbitration List* (visited Sept. 1, 2004) <<http://www.dir.ca.gov/csmcs/HowToRequestPanel.html>>.

¹⁰ Federal Mediation and Conciliation Service, *Arbitration FAQs* (visited Sept. 1, 2004) <<http://www.fmcs.gov/internet/faq.asp?categoryID=133>>.

¹¹ Federal Emergency Management Agency, *Arbitration Guidelines For The Cerro Grande Fires* (visited Sept. 1, 2004) <<http://www.fema.gov/cerrogrande/arbitration/guide.shtm>>.

¹² See, e.g., U.S. Bankruptcy Court for the Middle District of Tenn. (ADR Program); Minn. Rule 5530.0900; and Nevada Arbitration Rule 6.

lists more frequently than any other.¹³ While NASD acknowledges this anomaly in a random selection system, NASD believes that the benefits of such a system, such as ease of design, cost-efficient maintenance, and overall fairness of random selection (as well as the increased perception of fairness) will strengthen the operation of the forum.

NASD Dispute Resolution believes that the proposed rule change ultimately will protect investors and benefit the public by providing parties and arbitrators with an automated system, MATRICS, which will help the forum operate more efficiently while maintaining the core goal of providing arbitrators who have an equal probability of being listed for service on any given list of proposed arbitrators. In an effort to sustain the progress made on the MATRICS upgrades, NASD proposes to amend Rule 10308(b)(4) with a delayed implementation date, so that the developers can program this component for MATRICS using the random selection method of generating arbitrator lists in order to be ready when this phase of MATRICS becomes operational. NASD is, therefore, requesting accelerated review and approval for this proposed rule change to allow the programmers to begin creating the code, so that they will remain on development schedule while the Commission is reviewing the Code revisions.¹⁴ According to the technology development plan, NASD is scheduled to complete the arbitrator selection function of MATRICS in the third quarter of 2005. For the developers to meet this goal, NASD must amend the rule now to introduce the concept of random selection in order to provide the developers with the lead-time necessary to create the software and implement it on the MATRICS platform.¹⁵ While the software is being created, NLSS will continue to generate lists

¹³ In fact, the same comparative analysis conducted under a rotational method should yield a statistically similar result.

¹⁴ The proposed Customer Code and Industry Code revisions, which have already been filed with the SEC, contain a random selection provision. See note 4 above.

¹⁵ The alternative would result in duplicative effort and wasted resources, because programmers would have to develop and program MATRICS to select arbitrators under the current rules, and then discard that programming and create new software once the Code revision has been approved.

of arbitrators on a rotating basis. Subject to Commission approval of this rule, NASD will upgrade MATRICS with the random selection function, phase out NLSS, and replace it with MATRICS.

(b) Statutory Basis

NASD 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 the Association'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 Dispute Resolution believes that the proposed rule change ultimately will protect investors and benefit the public by providing parties with an automated system that will help the forum operate more efficiently.

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

NASD 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 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. 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 publication of notice of filing thereof because NASD Dispute Resolution has reached a critical stage in the upgrade of its computer technology platform. One of the most significant aspects of MATRICS will be its ability to generate lists of arbitrators. The Commission agrees that developing and programming a random selection function for MATRICS is the most significant component in this process because it will lay the foundation for future NLSS functions that are adapted for MATRICS. Therefore, as future releases are contingent upon the successful implementation of the random selection function, the Commission agrees that accelerated review and approval will allow the upgrades to continue as scheduled. Moreover, the Commission believes that the proposed rule change ultimately will protect investors and benefit the public by providing parties with an automated case management system that will help the forum operate more efficiently.

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 21 days from the date of publication].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary

January 5, 2005

Catherine McGuire
Associate Director and Chief Counsel
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2004-164 – Amendment No. 1 to Random Selection of Arbitrators

Dear Ms. McGuire:

On December 30, 2004, Division of Market Regulation staff requested that NASD confirm a statement Linda Fienberg made in a discussion with the Public Investors Arbitration Bar Association, in which NASD proposed to hire an outside consultant to audit the random selection system once it had become operational. This correspondence confirms the intent of NASD to hire an outside consultant to independently verify that the random selection system is operating as described in the proposed rule change. This audit will be conducted after the random selection system has been operational for one year.

In addition to this review, NASD will monitor the effectiveness of the random selection system by keeping statistics on arbitrators selected by the system to appear on a list.

If you have any questions, I can be reached at (202) 728-8151 or by email at Mignon.McLemore@NASD.com.

Very truly yours,

Mignon McLemore