

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁸

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SECURITIES AND EXCHANGE COMMISSION

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Self-Regulatory Organizations Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Creation of a Dispute Resolution Subsidiary

June 10, 1999.

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 on April 26, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned regulatory subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Commission is publishing this notice to solicit comments on the proposed rule change from interest persons.

I. Self Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Association 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. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

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Plan of Allocation and Delegation of Functions by NASD to Subsidiaries

I. NASD, Inc.

A. The NASD, Inc. (referenced as "NASD"), the Registered Section 15A Association, is the parent company of the wholly-owned Subsidiaries NASD

Regulation, Inc. (referenced individually as "NASD Regulation"),²² [and] The Nasdaq Stock Market, Inc. (referenced individually as "Nasdaq"), and NASD Dispute Resolution, Inc. (referenced individually as "NASD Dispute Resolution") (referenced collectively as the "Subsidiaries"). The term "Association" shall refer to the NASD and the Subsidiaries collectively.

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B. Functions and Authority of the NASD—The NASD shall have ultimate responsibility for the rules and regulations of the Association and its operation and administration. As set forth below in Sections II.A., [and] III.A, and V.A., the NASD has delegated certain authority and functions to its subsidiaries. Actions taken pursuant to delegated authority, however, remain subject to review, ratification or rejection by the NASD Board in accordance with procedures established by that Board. Any function or responsibility as a registered securities association under the Securities Exchange Act of 1934 ("Act"), or as set forth in the Certificate of Incorporation or the by-laws is hereby reserved, except as expressly delegated to the subsidiaries. In addition, the NASD expressly retains the following authority and functions:

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4. To review the rulemaking and disciplinary decisions of the subsidiaries (See Sections II.B., [and] III.B., and V.B. below).

5. No change.

6. To resolve any disputes [between] among the Subsidiaries.

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11. To take action "*ab initio*" in an area of responsibility delegated to NASD Regulation in Section II, [or] to Nasdaq in Section III, or to NASD Dispute Resolution in Section V.

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D. Access to and Status of Officers, Directors, Employees, Books, Records, and Premises of Subsidiaries

Notwithstanding the delegation of authority to the Subsidiaries, as set forth in Sections II.A., [and] III.A, and V.A. below, the staff, books, records, and premises of the NASD subject to oversight pursuant to the Act, and all officers, directors, employees, and agents of the Subsidiaries are officers, directors, employees and agents of the NASD for purposes of the Act. The books and records of NASDAQ shall be subject at all times to inspection and copying by NASD Regulation.

II. NASD Regulation, Inc.

A. Delegation of Functions and Authority:

1. Subject to Section 1.B.11, the NASD hereby delegates to NASD Regulation and NASD Regulation assumes the following responsibilities and functions as a registered securities association:

a. To establish and interpret rules and regulations and provide exemptions for NASD members including, but not limited to fees[,] and membership requirements[, and arbitration procedures].

b. To determine Association policy, including developing and adopting necessary or appropriate rule changes, relating to the business and sales practices of NASD members and associated persons with respect to, but not limited to, (i) [arbitration of disputes among and between NASD members, associated persons and customers, (ii)] public and private sale or distribution of securities including underwriting arrangements and compensation, [(iii)] (ii) financial responsibility, [(iv)] (iii) qualifications for NASD membership and association with NASD members, [(v)] (iv) clearance and settlement of securities transactions and other financial responsibility and operational matters affecting members in general and securities listed on The Nasdaq Stock Market and on other markets operated by the Nasdaq Stock Market, [(vi)] (v) NASD member advertising practices, [(vii)] (vi) administration, interpretation and enforcement of Association rules, [(viii)] (vii) administration and enforcement of Municipal Securities Rulemaking Board ("MSRB") rules, the federal securities laws, and other laws, rules and regulations that the Association has the authority to administer or enforce, and [(ix)] (viii) standards of proof for violations and sanctions imposed on NASD members and associated persons in connection with disciplinary actions.

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h. [To conduct arbitrations, mediations and other dispute resolution programs.

i.] To conduct qualification examinations and continuing education programs.

j.-t. Remembered as i.-s.

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B. NASD Regulation Board Procedures

1. Rule Filings—The NASD Board shall review and ratify a rule change adopted by the NASD Regulation Board before the rule change becomes the final action of the Association if the rule

⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

change: (a) imposes fees or other charges on persons or entities other than NASD members; (b) raises significant policy issues in the view of the NASD Regulation Board, and the NASD Regulation Board refers the rule change to the NASD Board; or (c) is materially inconsistent with a recommendation of the National Adjudicatory Council. If the NASD Regulation Board does not refer a rule change to the NASD Board for review, the NASD Regulation Board action shall become the final action of the Association unless called for review by any member of the NASD Board not later than the NASD Board meeting next following the NASD Regulation Board's action. During the process of developing rule proposals, NASD Regulation staff shall consult with and seek the advice of Nasdaq and NASD Dispute Resolution staff before presenting any rule proposal to the NASD Regulation Board.

C. Supplemental Delegation Regarding Committees

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[2. National Arbitration and Mediation Committee

a. The National Arbitration and Mediation Committee shall have the powers and authority pursuant to the Rules of the Association to advise the NASD Regulation Board on the development and maintenance of an equitable and efficient system of dispute resolution that will equally serve the needs of public investors and Association members, to monitor rules and procedures governing the conduct of dispute resolution, and to have such other powers and authority as is necessary to effectuate the purposes of the Rules of the Association.

b. The NASD Regulation Board shall appoint the National Arbitration and Mediation Committee by resolution. The National Arbitration and Mediation Committee shall consist of no fewer than ten and no more than 25 members. The members of the National Arbitration and Mediation Committee shall be equally balanced between Industry and Non-Industry committee members.

c. At all meetings of the National Arbitration and Mediation Committee, a quorum for the transaction of business shall consist of a majority of the National Arbitration and Mediation Committee, including not less than 50 percent of the Non-Industry committee members. If at least 50 percent of the Non-Industry Committee members are (i) present at or (ii) have filed a waiver of attendance for a meeting after receiving an agenda prior to such

meeting, the requirement that not less than 50 percent of the Non-Industry committee members be present to constitute the quorum shall be waived.]

[3]2. Operations Committee

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V. NASD Dispute Resolution, Inc.

A. Delegation of Functions and Authority

1. Subject to Section I.B.11, the NASD hereby delegates to NASD Dispute Resolution and NASD Dispute Resolution assumes the following responsibilities and functions as a registered securities association:

a. To establish and interpret rules and regulations and provide exemptions for NASD members pertaining to dispute resolution programs including, but not limited to, dispute resolution fees and procedures.

b. To determine Association policy, including developing and adopting necessary or appropriate rule changes, relating to the arbitration, mediation, or other resolution of disputes among and between NASD members, associated persons and customers.

c. To conduct arbitrations, mediations, and other dispute resolution programs.

d. To establish the annual budget and business plan for NASD Dispute Resolution.

e. To determine allocation of NASD Dispute Resolution resources.

f. To establish and assess fees and other charges on NASD members, persons associated with NASD members, and others using the services or facilities of NASD Dispute Resolution.

g. To manage external relations on matters related to dispute resolution with Congress, the Commission, state regulators, other self-regulatory organizations, business groups, and the public.

2. All action taken pursuant to authority delegated pursuant to A.1. shall be subject to the review, ratification, or rejection by the NASD Board in accordance with procedures established by the NASD Board.

B. NASD Dispute Resolution Board Procedures

Rule Filings—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; or (b) raises significant policy issues in the view of the NASD Dispute Resolution Board, and the

NASD Dispute Resolution Board refers the rule change to the NASD Board. If the NASD Dispute Resolution Board does not refer a rule change to the NASD Board for review, the NASD Dispute Resolution Board action shall become the final action of the Association unless called for review by any member of the NASD Board not later than the NASD Board meeting next following the NASD Dispute Resolution Board's action. During the process of developing rule proposals, NASD Dispute Resolution staff shall consult with and seek the advice of Nasdaq and NASD Resolution staff before presenting any rule proposal to the NASD Dispute Resolution Board.

C. Supplemental Delegation Regarding Committees

1. National Arbitration and Mediation Committee

a. The National Arbitration and Mediation Committee shall have the powers and authority pursuant to the Rules of the Association to advise NASD Dispute Resolution Board on the development and maintenance of an equitable and efficient system of dispute resolution that will equally serve the needs of public investors and Association members, to monitor rules and procedures governing the conduct of dispute resolution, and to have such other powers and authority as is necessary to effectuate the purposes of the Rules of the Association.

b. The NASD Dispute Resolution Board shall appoint the National Arbitration and Mediation Committee by resolution. The National Arbitration and Mediation Committee shall consist of no fewer than ten and no more than 25 members. The National Arbitration and Mediation Committee shall have at least 50 percent Non-Industry members.

c. At all meetings of the National Arbitration and Mediation Committee, a quorum for the transaction of business shall consist of a majority of the National Arbitration and Mediation Committee, including not less than 50 percent of the Non-Industry committee members. If at least 50 percent of the Non-Industry committee members are either (i) present at or (ii) have filed a waiver of attendance for a meeting after receiving an agenda prior to such meeting, the requirement that not less than 50 percent of the Non-Industry committee members be present to constitute the quorum shall be waived.

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By-Laws of NASD Regulation, Inc.

Article I—Definitions

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(q) "Industry Director" or "Industry Member" means a Director (excluding the President) or a National Adjudicatory Council or committee member who

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(6) has a consulting or employment relationship with or provide professional services to the NASD, NASD Regulation, Nasdaq, *NASD Dispute Resolution*, or Amex (and any predecessor), or has had any such relationship or provided any such services at any time within the prior three years;

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(t) "*NASD Dispute Resolution*" means *NASD Dispute Resolution, Inc.*;

(t)-(ff) Renumbered as (u) to (gg)

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Rules of the Association

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0120. Definitions

When used in these Rules, unless the context otherwise requires:

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(b) "Association"

The term "Association" means, collectively, the NASD, NASD Regulation, [and] Nasdaq, and *NASD Dispute Resolution*.

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Code of Arbitration Procedure

10102. National Arbitration and Mediation Committee

(a) The *NASD Dispute Resolution* Board of [Governors of the Association] *Directors*, following the annual election of its members [to] by the *NASD Board of Governors* shall appoint a National Arbitration and Mediation Committee of such size and composition including representation from the public at large, as it shall deem appropriate and in the public interest. The Chairman of the Committee shall be named by the Chairman of the *NASD Dispute Resolution* Board. The said Committee shall establish and maintain [a pool] *rosters* of [arbitrations] *neutrals* composed of persons from within and without the securities industry.

(b) The Committee shall have the authority to [establish] *recommend* to the *NASD Dispute Resolution* Board appropriate Rules, regulations, and procedures to govern the conduct of all arbitration, mediation, and other dispute resolution matters before the Association. All Rules, regulations, and procedures and amendments thereto [promulgated] *presented* by the Committee must be by a majority vote of all the members of the said Committee. It also shall have such other

power and authority as is necessary to effectuate the purposes of this code.

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10400. Mediation Rules

10401. Scope and Authority

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(b) A Director of Mediation shall be designated by the [Association] *NASD Dispute Resolution Board* to administer mediations under these Procedures. The Director will consult the [Association's] National Arbitration and Mediation Committee on the administration of mediations and the Committee shall, as necessary, make recommendations to the Director of Arbitration and recommend to the *NASD Dispute Resolution* Board [of Governors] amendments to the Procedures. The duties and functions of the Director may be delegated by the Director, as appropriate. For purposes of this Rule 10400 Series, the term "Director" refers to the Director of Mediation.

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10404. Mediator Selection

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(c) No mediator shall be permitted to serve as an arbitrator of any matter pending in [NASD] *Association* arbitration in which he served as a mediator, nor shall the mediator be permitted to represent any party or participant to the mediation in any subsequent [NASD] *Association* arbitration proceeding relating to the subject matter of the mediation.

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By-Laws of NASD Dispute Resolution, Inc.

Article I

Definitions

When used in these By-Laws, unless the context otherwise requires, the term:

(a) "Act" means the Securities Exchange Act of 1934, as amended;

(b) "Amex" means American Stock Exchange LLC;

(c) "Board" means the Board of Directors of *NASD Dispute Resolution*;

(d) "broker" means any individual, corporation, partnership, association, joint stock company, business trust, unincorporated organization, or other legal entity engaged in the business of effecting transactions in securities for the account of others, but does not include a bank;

(e) "Commission" means the Securities and Exchange Commission;

(f) "day" means calendar day;

(g) "dealer" means any individual, corporation, partnership, association, joint stock company, business trust,

unincorporated organization, or other legal entity engaged in the business of buying and selling securities for such individual's or entity's own account, through a broker or otherwise, but does not include a bank, or any person insofar as such person buys or sells securities for such person's own account, either individually or in some fiduciary capacity, but not as part of a regular business;

(h) "Delaware law" means the General Corporation Law of the State of Delaware;

(i) "Delegation Plan" means the "Plan of Allocation and Delegation of Functions by NASD to Subsidiaries" as approved by the Commission, and as amended from time to time;

(j) "Director" means a member of the Board, excluding the Chief Executive Officer of the NASD;

(k) "Executive Representative" means the executive representative of an NASD member appointed pursuant to Article IV, Section 3 of the NASD By-Laws;

(l) "Industry Director" or "Industry member" means a Director (excluding the President) or a committee member who (1) is or has served in the prior three years as an officer, director, or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (2) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenue received by the consolidated entity; (3) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (4) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or partnership; (5) provides professional services to a director, officer, or employee of a broker of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's officer's, or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director's or member's firm or

partnership; or (6) has a consulting or employment relationship with or provides professional services to the NASD, NASD Regulation, Nasdaq, NASD Dispute Resolution, or Amex (and any predecessor), or has had any such relationship or provided any such services at any time within the prior three years;

(m) "NASD" means the National Association of Securities Dealer, Inc.;

(n) "NASD Board" means the NASD Board of Governors;

(o) "NASD Dispute Resolution" means NASD Dispute Resolution, Inc.;

(p) "NASD member" means any broker or dealer admitted to membership in the NASD;

(q) "NASD Regulation" means NASD Regulation, Inc.;

(r) "Nasdaq" means The Nasdaq Stock Market, Inc.;

(s) "Nasdaq-Amex" means Nasdaq-Amex Market Group, Inc.;

(t) "National Nominating Committee" means the National Nominating Committee appointed pursuant to Article VII, Section 9 of the NASD By-Laws;

(u) "Non-Industry Director" or "Non-Industry member" means a Director (excluding the President) or committee member who is (1) a Public Director or Public member; (2) an officer or employee of an issuer of securities listed on Nasdaq or Amex, or traded in the over-the-counter market; or (3) any other individual who would not be an Industry Director or Industry member;

(v) "person associated with a member" or "associated person of a member" means: (1) a natural person registered under the Rules of the Association; or (2) a sole proprietor, partner, officer, director, or branch manager of a member, or a natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the NASD under these By-Laws or the Rules of the Association;

(w) "Public Director" or "Public member" means a Director or committee member who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, Nasdaq, or NASD Dispute Resolution;

(x) "Rules of the Association" or "Rules" means the numbered rules set forth in the NASD Manual beginning with the Rule 0100 Series, as adopted by the NASD Board pursuant to the NASD By-Laws, as hereafter amended or supplemented.

Article II

Offices

Location

Sec. 2.1 The address of the registered office of NASD Dispute Resolution in the State of Delaware and the name of the registered agent at such address shall be: The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801. NASD Dispute Resolution also may have offices at such other places both within and without the State of Delaware as the Board may from time to time designate or the business of NASD Dispute Resolution may require.

Change of Location

Sec. 2.2 In the manner permitted by law, the Board or the registered agent may change the address of NASD Dispute Resolution's registered office in the State of Delaware and the Board may make, revoke, or change the designation of the registered agent.

Article III

Meetings of the Stockholder

Action by Consent of Stockholder

Sec. 3.1 Any action required or permitted by law to be taken at any meeting of the stockholder of NASD Dispute Resolution may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, is signed by the holder of the outstanding stock.

Article IV

Board of Directors

General Powers

Sec. 4.1 The property, business, and affairs of NASD Dispute Resolution shall be managed by or under the direction of the Board. The Board may exercise all such powers of NASD Dispute Resolution and have the authority to perform all such lawful acts as are permitted by law, the Certificate of Incorporation, these By-Laws, or the Delegation Plan to assist the NASD in fulfilling its self-regulatory responsibilities as set forth in Section 15A of the Act, and to support such other initiatives as the Board may deem appropriate. To the fullest extent permitted by applicable law, the Certificate of Incorporation, and these By-Laws, the Board may delegate any of its powers to a committee appointed pursuant to Section 4.13 or to NASD Dispute Resolution staff in a manner not inconsistent with the Delegation Plan.

Number of Directors

Sec. 4.2 The Board shall consist of no fewer than five and no more than eight Directors, the exact number to be determined by resolution adopted by the stockholder of NASD Dispute Resolution from time to time. Any new Director position created as a result of an increase in the size of the Board shall be filled pursuant to Section 4.4.

Qualifications

Sec. 4.3 (a) Directors need not be stockholders of NASD Dispute Resolution. The number of Non-Industry Directors shall equal or exceed the number of Industry Directors plus the President. The Board shall include the President, at least two Non-Industry Directors who are also Governors of the NASD Board, and at least one Industry Director who is also a Governor of the NASD Board. The Board shall include at least one Public Director, unless the Board consists of eight Directors. In such case, at least two Directors shall be Public Directors. The Chief Executive Officer of the NASD shall be an ex-officio non-voting member of the board.

(b) As soon as practicable, following the annual election of Directors, the Board shall elect from its members a Chair and Vice Chair and such other persons having such titles as it shall deem necessary or advisable to serve until the next annual election or until their successors are chosen and qualified. The persons so elected shall have such powers and duties as may be determined from time to time by the Board. The Board, by resolution adopted by a majority of Directors then in office, may remove any such person from such position at any time.

Election

Sec. 4.4 Except as otherwise provided by law, these By-Laws, or the Delegation Plan, after the first meeting of NASD Dispute Resolution at which Directors are elected, Directors of NASD Dispute Resolution shall be elected each year at the annual of the stockholder, or at a special meeting called for such purpose in lieu of the annual meeting. If the annual election of Directors is not held on the date designated therefor, the Directors shall cause such election to be held as soon thereafter as convenient.

Resignation

Sec. 4.5 Any Director may resign at any time either upon written notice of resignation to the Chair of the Board, the President, or the Secretary. Any such resignation shall take effect at the time specified therein or, if the time is not specified, upon receipt thereof, and the acceptance of such resignation,

unless required by the terms thereof, shall not be necessary to make such resignation effective.

Removal

Sec. 4.6 Any or all of the Directors may be removed from office at any time, with or without cause, only by a majority vote of the NASD Board.

Disqualification

Sec. 4.7 The term of office of a Director shall terminate immediately upon a determination by the Board, by a majority vote of the remaining Directors, that: (a) the Director no longer satisfies the classification for which the Director was elected; and (b) the Director's continued service as such would violate the compositional requirements of the Board set forth in Section 4.3. If the term of office of a Director terminates under this Section, and the remaining term of office of such Director at the time of termination is not more than six months, during the period of vacancy the Board shall not be deemed to be in violation of Section 4.3 by virtue of such vacancy.

Filling of Vacancies

Sec. 4.8 If a Director position becomes vacant, whether because of death, disability, disqualification, removal, or resignation, the National Nominating Committee shall nominate, and the NASD Board shall elect by majority vote, a person satisfying the classification (Industry or Non-Industry Director) for the directorship as provided in Section 4.3 to fill such vacancy, except that if the remaining term of office for the vacant Director position is not more than six months, no replacement shall be required.

Quorum and Voting

Sec. 4.9 (a) At all meetings of the Board, unless otherwise set forth in these By-Laws or required by law, a quorum for the transaction of business shall consist of a majority of the Board, including not less than 50 percent of the Non-Industry Directors. In the absence of a quorum, a majority of the Directors present may adjourn the meeting until a quorum is present.

(b) Except as provided in Section 4.14(b), the vote of a majority of the Directors present at a meeting at which a quorum is present shall be the act of the Board.

Regulation

Sec. 4.10 The Board may adopt such rules, regulations, and requirements for the conduct of the business and management of NASD Dispute Resolution not inconsistent with the

law, the Certificate of Incorporation, these By-Laws, the Delegation Plan, the Rules of the Association, or the By-Laws of the NASD, as the Board may deem proper. A Director shall, in the performance of such Director's duties, be fully protected in relying in good faith upon the books of account or reports made to NASD Dispute Resolution by any of its officers, by an independent certified public accountant, by an appraiser selected with reasonable care by the Board or any committee of the Board or by any agent of NASD Dispute Resolution, or in relying in good faith upon other records of NASD Dispute Resolution.

Meetings

Sec. 4.11 (a) An annual meeting of the Board shall be held for the purpose of organization, election of officers, and transaction of any other business. If such meeting is held promptly after and at the place specified for the annual meeting of the stockholder, no notice of the annual meeting of the Board need be given. Otherwise, such annual meeting shall be held at such time and place as may be specified in a notice given in accordance with Section 4.12.

(b) Regular meetings of the Board may be held at such time and place, within or without the State of Delaware, as determined from time to time by the Board. After such determination has been made, notice shall be given in accordance with Section 4.12.

(c) Special meetings of the Board may be called by the Chair of the Board, by the President, or by at least one-third of the Directors then in office. Notice of any special meeting of the Board shall be given to each Director in accordance with Section 4.12.

(d) A Director or member of any committee appointed by the Board may participate in a meeting of the Board or of such committee through the use of a conference telephone or similar communications equipment by means of which all persons participating in the meeting may hear one another, and such participation in a meeting shall constitute presence in person at such meeting for all purposes.

Notice of Meetings; Waiver of Notice

Sec. 4.12 (a) Notice of any meeting of the Board shall be deemed to be duly given to a Director if: (i) mailed to the address last made known in writing to NASD Dispute Resolution by such Director as the address to which such notices are to be sent, at least seven days before the day on which such meeting is to be held; (ii) sent to the Director at such address by telegraph, telefax, cable, radio, or wireless, not

later than the day before the day on which such meeting is to be held; or (iii) delivered to the Director personally or orally, by telephone or otherwise, not later than the day before the day on which such meeting is to be held. Each notice shall state the time and place of the meeting and the purpose(s) thereof.

(b) Notice of any meeting of the Board need not be given to any Director if waived by that Director in writing (or by telegram, telefax, cable, radio, or wireless and subsequently confirmed in writing) whether before or after the holding of such meeting, or if such Director is present at such meeting, subject to Article IX, Section 9.3(b).

(c) Any meeting of the Board shall be a legal meeting without any prior notice if all Directors then in office shall be present thereat.

Committees

Sec. 4.13 (a) The Board may, by resolution or resolutions adopted by a majority of the whole Board, appoint one or more committees. Except as herein provided, vacancies in membership of any committee shall be filled by the vote of a majority of the whole Board. The Board may designate one or more Directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of any member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not such member or members constitute a quorum, may unanimously appoint another Director to act at the meeting in the place of any such absent or disqualified member. Members of a committee shall hold office for such period as may be fixed by a resolution adopted by a majority of the whole Board. Any member of a committee may be removed from such committee only after a majority vote of the whole Board, after appropriate notice, for refusal, failure, neglect, or inability to discharge such member's duties.

(b) The Board may, by resolution or resolutions adopted by a majority of the whole Board, delegate to one or more committees the power and authority to act on behalf of the Board in carrying out the functions and authority delegated to NASD Dispute Resolution by the NASD under the Delegation Plan. Such delegations shall be in conformance with applicable law, the Certificate of Incorporation, these By-Laws, and the Delegation Plan. Action taken by a committee pursuant to such delegated authority shall be subject to review, ratification, or rejection by the

Board. In all other matters, the Board may, by resolution or resolutions adopted by a majority of the whole Board, delegate to one or more committees that consist solely of one or more Directors the power and authority to act on behalf of the Board in the management of the business and affairs of NASD Dispute Resolution to the extent permitted by law and not inconsistent with the Delegation Plan. A committee, to the extent permitted by law and provided in the resolution or resolutions creating such committee, may authorize the seal of NASD Dispute Resolution to be affixed to all papers that may require it.

(c) Except as otherwise permitted by applicable law, no committee shall have the power or authority of the Board with regard to: amending the Certificate of Incorporation or the By-Laws of NASD Dispute Resolution; adopting an agreement of merger or consolidation; recommending to the stockholder the sale, lease, or exchange of all or substantially all NASD Dispute Resolution's property and assets; or recommending to the stockholder a dissolution of NASD Dispute Resolution or a revocation of a dissolution. Unless the resolution of the Board expressly so provides, no committee shall have the power or authority to authorize the issuance of stock.

(d) Each committee may adopt its own rules of procedure and may meet at stated times or on such notice as such committee may determine. Each committee shall keep regular minutes of its proceedings and report the same to the Board when required.

(e) Unless otherwise provided by these By-Laws, a majority of a committee shall constitute a quorum for the transaction of business, and the vote of a majority of the members of such committee present at a meeting at which a quorum is present shall be an act of such committee.

(f) The Board may appoint an Executive Committee, which shall, to the fullest extent permitted by Delaware law and other applicable law, have and be permitted to exercise all the powers and authority of the Board in the management of the business and affairs of NASD Dispute Resolution between meetings of the Board, and which may authorize the seal of NASD Dispute Resolution to be affixed to all papers that may require it. The Executive Committee shall consist of three or four Directors, including at least one Public Director. The President of NASD Dispute Resolution shall be a member of the Executive Committee. The number of Non-Industry committee members shall equal or exceed the number of

Industry committee members plus the President. An Executive Committee member shall hold office for a term of one year. At all meetings of the Executive Committee, a quorum for the transaction of business shall consist of a majority of the Executive Committee, including not less than 50 percent of the Non-Industry committee members. In the absence of a quorum, a majority of the committee members present may adjourn the meeting until a quorum is present.

(g) The Board may appoint a Finance Committee. The Finance Committee shall advise the Board with respect to the oversight of the financial operations and conditions of NASD Dispute Resolution, including recommendations for NASD Dispute Resolution's annual operating and capital budgets and proposed changes to the rates and fees charged by NASD Dispute Resolution. The Finance Committee shall consist of two or three Directors. The President of NASD Dispute Resolution shall serve as a member of the Committee. A Finance Committee member shall hold office for a term of one year.

(h) If the Board appoints a non-Director to a committee, upon request of the Secretary of NASD Dispute Resolution, each such prospective committee member shall provide to the Secretary such information as is reasonably necessary to serve as the basis for a determination of the prospective committee member's classification as an Industry or Non-Industry committee member. The Secretary of NASD Dispute Resolution shall certify to the Board each prospective committee member's classification. Such committee members shall update the information submitted under this Section at least annually and upon request of the Secretary of NASD Dispute Resolution, and shall report immediately to the Secretary any change in such classification.

Conflicts of Interest; Contracts and Transactions Involving Directors

Sec. 4.14 (a) A Director or a committee member shall not directly or indirectly participate in any determinations regarding the interests of any party if that Director or committee member has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned. In any such case, the Director or committee member shall recuse himself or herself or shall be disqualified in accordance with the Rules of the Association.

(b) No contract or transaction between NASD Dispute Resolution and one or more of its Directors or officers, or

between NASD Dispute Resolution and any other corporation, partnership, association, or other organization in which one or more of its Directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason if: (i) the material facts pertaining to such Director's or officer's relationship or interest and the contract or transaction are disclosed or are known to the Board or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested Directors; (ii) the material facts are disclosed or become known to the Board or committee after the contract or transaction is entered into, and the Board or committee in good faith ratifies the contract or transaction by the affirmative vote of a majority of the disinterested Directors; or (iii) the material facts pertaining to the Director's or officer's relationship or interest and the contract or transaction are disclosed or are known to the stockholder entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholder. Only disinterested Directors may be counted in determining the presence of a quorum at the portion of a meeting of the Board or of a committee that authorizes the contract or transaction. This subsection shall not apply to a contract or transaction between NASD Dispute Resolution and the NASD, NASD Regulation, Nasdaq, Nasdaq-Amex, or Amex.

Action Without Meeting

Sec. 4.15 Any action required or permitted to be taken at a meeting of the Board or of a committee may be taken without a meeting if all Directors or all members of such committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or the committee.

Communication of Views Regarding Contested Election or Nomination

Sec. 4.16 NASD Dispute Resolution, the Board, any committee, and NASD Dispute Resolution staff shall not take any position publicly or with an NASD member or person associated with or employed by a member with respect to any candidate in a contested election or nomination held pursuant to the NASD By-Laws or the NASD Regulation By-Laws. A Director or committee member may communicate his or her views with respect to a candidate if such individual acts solely in his or her individual capacity and disclaims any intention to

communicate in any official capacity on behalf of NASD Dispute Resolution, the Board, or any committee. NASD Dispute Resolution, the Board, any committee, and the NASD Dispute Resolution staff shall not provide any administrative support to any candidate in a contested election or nomination conducted pursuant to the NASD By-Laws or the NASD Regulation By-Laws.

Article V

Officers, Agents, and Employees

Officers

Sec. 5.1 The Board shall elect the officers of NASD Dispute Resolution, which shall include a President, a Secretary, and such other executive or administrative officers as it shall deem necessary or advisable, including, but not limited to: Executive Vice President, Senior Vice President, Vice President, General Counsel, and Treasurer of NASD Dispute Resolution. All such officers shall have such titles, powers, and duties, and shall be entitled to such compensation, as shall be determined from time to time by the Board. The terms of office of such officers shall be at the pleasure of the Board, which by affirmative vote of a majority of the Board, may remove any such officer at any time. One person may hold the offices and perform the duties of any two or more of said offices, except the offices and duties of President and Vice President or of President and Secretary. None of the officers except the President, need be Directors of NASD Dispute Resolution.

Absence of the President

Sec. 5.2 In the case of the absence or inability to act of the President of NASD Dispute Resolution, or in the case of a vacancy in such office, the Board may appoint its Chair or such other person as it may designate to act as such officer pro tem, who shall assume all the functions and discharge all the duties of the President.

Agents and Employees

Sec. 5.3 In addition to the officers, NASD Dispute Resolution may employ such agents and employees as the Board may deem necessary or advisable, each of whom shall hold office for such period and exercise such authority and perform such duties as the Board, the President, or any officer designated by the Board may from time to time determine. Agents and employees of NASD Dispute Resolution shall be under the supervision and control of the officers of the NASD Dispute Resolution, unless the Board, by resolution, provides that an agent or employee shall

be under the supervision and control of the Board.

Delegation of Duties of Officers

Sec. 5.4 The Board may delegate the duties and powers of any officer of NASD Dispute Resolution to any other officer or to any Director for a specified period of time and for any reason that the Board may deem sufficient.

Resignation and Removal of Officers

Sec. 5.5 (a) Any officer may resign at any time upon written notice of resignation to the Board, the President, or the Secretary. Any such resignation shall take effect upon receipt of such notice or at any later time specified therein. The acceptance of a resignation shall not be necessary to make the resignation effective.

(b) Any officer of NASD Dispute Resolution may be removed, with or without cause, by resolution adopted by a majority of the Directors then in office at any regular or special meeting of the Board or by a written consent signed by all of the Directors then in office. Such removal shall be without prejudice to the contractual rights of the affected officer, if any, with NASD Dispute Resolution.

Bond

Sec. 5.6 NASD Dispute Resolution may secure the fidelity of any or all of its officers, agents, or employees by bond or otherwise.

Article VI

Compensation

Compensation of Board, Council, and Committee Members

Sec. 6.1 The Board may provide for reasonable compensation of the Chair of the Board, the Directors, and the members of any committee of the Board. The Board may also provide for reimbursement of reasonable expenses incurred by such persons in connection with the business of NASD Dispute Resolution.

Article VII

Indemnification

Indemnification of Directors, Officers, Employees, Agents, and Committee Members

Sec. 7.1 (a) NASD Dispute Resolution shall indemnify, and hold harmless, to the fullest extent permitted by Delaware law as it presently exists or may thereafter be amended, any person (and the heirs, executors, and administrators of such person) who, by reason of the fact that he or she is or was a Director, officer, or employee of NASD Dispute Resolution or a

committee member, or is or was a Director, officer, or employee of NASD Dispute Resolution who is or was serving at the request of NASD Dispute Resolution as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, enterprise, or non-profit entity, including service with respect to employee benefit plans, is or was a party, or is threatened to be made a party to:

(i) any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative (other than an action by or in the right of NASD Dispute Resolution) against expenses (including attorneys' fees and disbursements), judgments, fines, and amounts paid in settlement actually and reasonably incurred by such person in connection with any such action, suit, or proceeding; or

(ii) any threatened, pending, or completed action or suit by or in the right of NASD Dispute Resolution to procure a judgment in its favor against expenses (including attorneys' fees and disbursements) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit.

(b) NASD Dispute Resolution shall advance expenses (including attorneys' fees and disbursements) to persons described in subsection (a); provided, however, that the payment of expenses incurred by such person in advance of the final disposition of the matter shall be conditioned upon receipt of a written undertaking by that person to repay all amounts advanced if it should be ultimately determined that the person is not entitled to be indemnified under this Section or otherwise.

(c) NASD Dispute Resolution may, in its discretion, indemnify and hold harmless, to the fullest extent permitted by Delaware law as it presently exists or may thereafter be amended, any person (and the heirs, executors, and administrators of such persons) who, by reason of the fact that he or she is or was an agent of NASD Dispute Resolution or is or was an agent of NASD Dispute Resolution who is or was serving at the request of NASD Dispute Resolution as a director, officer, employee, or agent of another corporation, partnership, trust, enterprise, or non-profit entity, including service with respect to employee benefit plans, was or is a party, or is threatened to be made a party to any action or proceeding described in subsection (a).

(d) NASD Dispute Resolution may, in its discretion, pay the expenses

(including attorneys' fees and disbursements) reasonably and actually incurred by an agent in defending any action, suit, or proceeding in advance of its final disposition, provided, however, that the payment of expenses incurred by such person in advance of the final disposition of the matter shall be conditioned upon receipt of a written undertaking by that person to repay all amounts advanced if it should be ultimately determined that the person is not entitled to be indemnified under this Section or otherwise.

(e) Notwithstanding the foregoing or any other provision of these By-Laws, no advance shall be made by NASD Dispute Resolution to an agent or non-officer employee if a determination is reasonably and promptly made by the Board by a majority vote of those Directors who have not been named parties to the action, even though less than a quorum, or, if there are no such Directors or if such Directors so direct, by independent legal counsel, that, based upon the facts known to the Board or such counsel at the time such determination is made: (1) the person seeking advancement of expense (i) acted in bad faith, or (ii) did not act in a manner that he or she reasonably believed to be in or not opposed to the best interests of NASD Dispute Resolution; (2) with respect to any criminal proceeding, such person believed or had reasonable cause to believe that his or her conduct was unlawful; or (3) such person deliberately breached his or her duty to NASD Dispute Resolution.

(f) The indemnification provided by this Section in a specific case shall not be deemed exclusive of any other rights to which a person seeking indemnification may be entitled, both as to action in his or her official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a Director, officer, or committee member, employee, or agent and shall inure to the benefit of such person's heirs, executors, and administrators.

(g) Notwithstanding the foregoing, but subject to subsection (j), NASD Dispute Resolution shall be required to indemnify any person identified in subsection (a) in connection with a proceeding (or part thereof) initiated by such person only if the initiation of such proceeding (or part thereof) by such person was authorized by the Board.

(h) NASD Dispute Resolution's obligation, if any, to indemnify or advance expenses to any person who is or was serving at its request as a director, officer, employee, or agent of another corporation, partnership, joint

venture, trust, enterprise, or non-profit entity shall be reduced by any amount such person may collect as indemnification or advancement from such other corporation, partnership, joint venture, trust, enterprise, or non-profit entity.

(i) Any repeal or modification of the foregoing provisions of this Section shall not adversely affect any right or protection hereunder of any person respecting any act or omission occurring prior to the time of such repeal or modification.

(j) If a claim for indemnification or advancement of expenses under this Article is not paid in full within 60 days after a written claim therefor by an indemnified person has been received by NASD Dispute Resolution, the indemnified person may file suit to recover the unpaid amount of such claim and, if successful in whole or in part, shall be entitled to be paid the expense of prosecuting such claim. In any such action, NASD Dispute Resolution shall have the burden of proving that the indemnified person is not entitled to the requested indemnification or advancement of expenses under Delaware law.

Indemnification Insurance

Sec. 7.2 NASD Dispute Resolution shall have power to purchase and maintain insurance on behalf of any person who is or was a Director, officer, committee member, employee, or agent of NASD Dispute Resolution, or is or was serving at the request of NASD Dispute Resolution as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, enterprise, or non-profit entity against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not NASD Dispute Resolution would have the power to indemnify such person against such liability hereunder.

Article VIII

Capital Stock

Sole Stockholder

Sec. 8.1 The NASD shall be the sole stockholder of the capital stock of NASD Dispute Resolution.

Certificates

Sec. 8.2 The stockholder shall be entitled to a certificate or certificates in such form as shall be approved by the Board, certifying the number of shares of capital stock in NASD Dispute Resolution owned by the stockholder.

Signatures

Sec. 8.3 (a) Certificates for shares of capital stock of NASD Dispute Resolution shall be signed in the name of NASD Dispute Resolution by two officers with one being the Chair of the Board, the President, or a Vice President, and the other being the Secretary, the Treasurer, or such other officer that may be authorized by the Board. Such certificates may be sealed with the corporate seal of NASD Dispute Resolution or a facsimile thereof.

(b) If any such certificates are countersigned by a transfer agent other than NASD Dispute Resolution or its employee, or by a registrar other than NASD Dispute Resolution or its employee, any other signature on the certificate may be a facsimile. In the event that any officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed upon a certificate shall cease to be such officer, transfer agent, or registrar before such certificate is issued, such certificate may be issued by NASD Dispute Resolution with the same effect as if such person were such officer, transfer agent, or registrar at the date of issue.

Stock Ledger

Sec. 8.4 (a) A record of all certificates for capital stock issued by NASD Dispute Resolution shall be kept by the Secretary or any other officer, employee, or agent designated by the Board. Such record shall show the name and address of the person, firm, or corporation in which certificates for capital stock are registered, the number of shares represented by each such certificate, the date of each such certificate, and in the case of certificates that have been canceled, the date of cancellation thereof.

(b) NASD Dispute Resolution shall be entitled to treat the holder of record of shares of capital stock as shown on the stock ledger as the owner thereof and as the person entitled to vote such shares and to receive notice of meetings, and for all other purposes. Except as otherwise required by applicable law, NASD Dispute Resolution shall not be bound to recognize any equitable or other claim to or interest in any share of capital stock on the part of any other person, whether or not NASD Dispute Resolution shall have express or other notice thereof.

Transfers of Stock

Sec. 8.5 (a) The Board may make such rules and regulations as it may deem expedient, not inconsistent with law, the Certificate of Incorporation, or

these By-Laws, concerning the issuance, transfer, and registration of certificates for shares of capital stock of NASD Dispute Resolution. The Board may appoint, or authorize any principal officer to appoint, one or more transfer agents or one or more transfer clerks and one or more registrars and may require all certificates for capital stock to bear the signature or signatures of any of them.

(b) Transfers of capital stock shall be made on the books of NASD Dispute Resolution only upon delivery to NASD Dispute Resolution or its transfer agent of: (i) a written direction of the registered holder named in the certificate or such holder's attorney lawfully constituted in writing; (ii) the certificate for the shares of capital stock being transferred; and (iii) a written assignment of the shares of capital stock evidenced thereby.

Cancellation

Sec. 8.6 Each certificate for capital stock surrendered to NASD Dispute Resolution for exchange or transfer shall be canceled and no new certificate or certificates shall be issued in exchange for any existing certificate other than pursuant to Section 8.7 until such existing certificate shall have been canceled.

Lost, Stolen, Destroyed, and Mutilated Certificates

Sec. 8.7 In the event that any certificate for shares of capital stock of NASD Dispute Resolution shall be mutilated, NASD Dispute Resolution shall issue a new certificate in place of such mutilated certificate. In the event that any such certificate shall be lost, stolen, or destroyed NASD Dispute Resolution may, in the discretion of the Board or a committee appointed thereby with power so to act, issue a new certificate for capital stock in the place of any such lost, stolen, or destroyed certificate. The applicant for any substituted certificate or certificates shall surrender any mutilated certificate or, in the case of any lost, stolen, or destroyed certificate, furnish satisfactory proof of such loss, theft, or destruction of such certificate and of the ownership thereof. The Board or such committee may, in its discretion, require the owner of a lost or destroyed certificate, or such owner's representatives, to furnish to NASD Dispute Resolution a bond with an acceptable surety or sureties and in such sum as shall be sufficient to indemnify NASD Dispute Resolution against any claim that may be made against it on account of the lost, stolen, or destroyed certificate or the issuance

of such new certificate. A new certificate may be issued without requiring a bond when, in the judgment of the Board, it is proper to do so.

Fixing of Record Date

Sec. 8.8 The Board may fix a record date in accordance with Delaware law.

Article IX

Miscellaneous Provisions

Corporate Seal

Sec. 9.1 The seal of NASD Dispute Resolution shall be circular in form and shall bear, in addition to any other emblem or device approved by the Board, the name of NASD Dispute Resolution, the year of its incorporation, and the words "Corporate Seal" and "Delaware." The seal may be used by causing it to be affixed or impressed, or a facsimile thereof may be reproduced or otherwise used in such manner as the Board may determine.

Fiscal Year

Sec. 9.2 The fiscal year of NASD Dispute Resolution shall begin on the first day of January in each year, or such other month as the Board may determine by resolution.

Waiver of Notice

Sec. 9.3 (a) Whenever notice is required to be given by law, the Certificate of Incorporation, or these By-Laws, a written waiver thereof, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the stockholder, Directors, of members of a committee of directors need be specified in any written waiver of notice.

(b) Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

Execution of Instruments, Contracts, Etc.

Sec. 9.4 (a) All checks, drafts, bills of exchange, notes, or other obligations or orders for the payment of money shall be signed in the name of NASD Dispute Resolution by such officer or officers or person or persons as the Board, or a duly authorized committee thereof, may from time to time designate. Except as otherwise provided by law, the Board, any committee given specific authority

in the premises by the Board, or any committee given authority to exercise generally the powers of the Board during intervals between meetings of the Board, may authorize any officer, employee, or agent, in the name of and on behalf of NASD Dispute Resolution, to enter into or execute and deliver deeds, bonds, mortgages, contracts, and other obligations or instruments, and such authority may be general or confined to specific instances.

(b) All applications, written instruments, and papers required by any department of the United States Government or by any state, county, municipal, or other governmental authority, may be executed in the name of NASD Dispute Resolution by any principal officer or subordinate officer of NASD Dispute Resolution, or, to the extent designated for such purpose from time to time by the Board, by an employee or agent of NASD Dispute Resolution. Such designation may contain the power to substitute, in the discretion of the person named, one or more other persons.

Form of Records

Sec. 9.5 Any records maintained by NASD Dispute Resolution in the regular course of business, including its stock ledger, books of account, and minute books, may be kept on, or be in the form of, magnetic tape, computer disk, or any other information storage device, provided that the records so kept can be converted into clearly legible form within a reasonable time.

Article X

Amendments; Emergency by-Laws

By Stockholder

Sec 10.1 These By-Laws may be altered, amended, or repealed, or new By-Laws may be adopted, at any meeting of the stockholder, provided that, in the case of a special meeting, notice that an amendment is to be considered and acted upon shall be inserted in the notice or waiver of notice of said meeting.

By Directors

Sec 10.2 To the extent permitted by the Certificate of Incorporation, these By-Laws may be altered, amended, or repealed, or new By-Laws may be adopted, at any regular or special meeting of the Board.

Emergency By-Laws

Sec 10.3 The Board may adopt emergency By-Laws subject to repeal or change by action of the stockholder that shall, notwithstanding any different provision of law, the Certificate of

Incorporation, or these By-Laws, be operative during any emergency resulting from any nuclear or atomic disaster, an attack on the United States or on a locality in which NASD Dispute Resolution conducts its business or customarily holds meetings of the Board or stockholder, any catastrophe, or other emergency condition, as a result of which a quorum of the Board or a committee thereof cannot readily be convened for action. Such emergency By-Laws may make any provision that may be practicable and necessary under the circumstances of the emergency.

* * * * *

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 Regulation 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 places specified in Item IV below. NASD Regulation 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

1. Purpose

The proposed rule change is intended to create a new subsidiary to handle dispute resolution programs and to make certain related changes.

a. Background

The Association's arbitration and mediation programs were operated by the NASD Arbitration Department until 1996, when those functions were moved to NASD Regulation following a corporate reorganization. This reorganization in part grew out of recommendations of a Select Committee formed by the NASD and made up of individuals with significant experience in the securities industry and NASD governance ("the Rudman Committee"). This review took place from December 1994 through August 1995, and the Rudman Report was issued in September 1995.

Meanwhile, in September 1994, the NASD established the Arbitration Policy Task Force, headed by David S. Ruder, former Chairman of the SEC ("the Ruder Task Force"), to study NASD arbitration and recommend improvements. The Ruder Task Force, composed of eight

persons with various backgrounds in the area of securities arbitration, met from the fall of 1994 to January 1996, when its Report was issued.

Both the Rudman Committee and the Ruder Task Force made recommendations that affected the arbitration program. The Rudman Committee recommended that the NASD reorganize as a parent corporation with two relatively autonomous and strong operating subsidiaries, independent of one another. The resulting enterprise would consist of NASD Inc., as parent, The Nasdaq Stock Market, Inc. ("Nasdaq") as one subsidiary to operate the Nasdaq market, and a new subsidiary, NASD Regulation, Inc. to regulate the broker/dealer profession.³ The Ruder Task Force Report, *Securities Arbitration Reform*, issued in January 1996, recommended that the dispute resolution program be housed either in the parent or in NASD Regulation (Report at 151-52). The Arbitration Department was placed in NASD Regulation in early 1996 based on the recommendation of the Rudman Committee,⁴ and the name of the department was changed to the Office of Dispute Resolution (ODR) shortly thereafter, to reflect the broader range of dispute resolution mechanisms.

The NASD believes that ODR has established credibility as a neutral forum that is fair to all parties and has gained acceptance by investor groups. Because there are significant differences

between the disciplinary role of NASD Regulation and the sponsorship of a neutral forum for the resolution of disputes between members, associated persons, and customers, however, the NASD believes that creation of a separate dispute resolution entity will further strengthen the independence and credibility of the arbitration and mediation functions. A new dispute resolution subsidiary will benefit from the perception that it is separate and distinct from other NASD entities. The new subsidiary will be subject to the same SEC oversight as other parts of the NASD enterprise, which includes regular inspections by the SEC and the need to file all by-laws and rule changes with the SEC.⁵ In addition, the new subsidiary will remain subject to inspections by the General Accounting Office (GAO), which performs audits at the request of Congress.

The NASD proposes to call the new subsidiary NASD Dispute Resolution, Inc. ("NASD Dispute Resolution"), and proposes to incorporate and organize it in much the same way as NASD Regulation. Like ODR, the subsidiary would be part of the NASD Regulatory and Dispute Resolution Group.

Staffing for NASD Dispute Resolution will be the same as at present, except for the creation of a President position and the possible creation of certain other executive positions. Certain functions, such as human resources, legal, finance, communications, administrative services, and technology will be shared with the NASD and other subsidiaries to avoid duplication; the new subsidiary will be transfer-priced (charged) for the cost of those functions as it presently is.

Funding for the new subsidiary will be handled in much the same way as at present. Currently, ODR is not self supporting. Fees received from parties who use the arbitration and mediation programs are not sufficient to fund the Office's regular activities. Rather, as a part of NASD Regulation, ODR shares in the revenue stream of the overall NASD enterprise, which includes revenue derived from member assessments, various fees and charges, disciplinary fines, and other sources of income. In return, ODR is charged for services that it receives from the other corporations in the enterprise as described above.

³ Report of the NASD Select Committee on Structure and Governance to the NASD Board of Governors ("Rudman Report") at R-8. As described in the Rudman Report, "The new NASDR subsidiary would thus be responsible for the NASD's regulation of the broker-dealer profession, and not for regulating or operating any OTC market, including Nasdaq. NASDR would promulgate and administer Rules of Fair Practice, membership rules, and operational requirements for NASD member firms; oversee the examination and investigation of member firms and registered representatives; administer the district offices; bring enforcement actions for rule violations (including violations of OTC trading rules, whether referred by Nasdaq, another authority or uncovered by the NASDR itself), and administer the adjudicative machinery for all NASD disciplinary actions. NASDR would also assume NASD's other membership regulatory functions, such as advertising reviews, corporate finance reviews, arbitration, and administration of the CRD." Rudman Report at R-8.

⁴ Rudman Report at R-8. That Report noted, "Unlike Nasdaq, NASDR would not be responsible for operating any securities market or associated market systems. Rather, NASDR would be the NASD's strong, independent regulatory arm, responsible for oversight of the broker-dealer profession, and the programs (such as licensing, advertising and corporate finance review, and arbitration) that the NASD performs for the industry as a whole. The NASDR Board should thus be constituted to perform effective, independent regulatory oversight, with 50% public representation." Rudman Report at R-12.

⁵ In a release approving an NASD rule change, the SEC noted: "The Commission oversees the arbitration programs of the SROs, like the NASD, through inspections of the SRO facilities and the review of SRO arbitration rules. Inspections are conducted to identify areas where procedures should be strengthened, and to encourage remedial steps either through changes in administration or through the development of rule changes." Exchange Act Release No. 40109, n. 53 (June 22, 1998), 63 FR 35299 (June 29, 1998).

Apart from accounting changes to reflect the new subsidiary's status, the current funding process for ODR will be the same for the new subsidiary. ODR employees will continue in the same positions in the new subsidiary, and the physical offices will not move.

The NASD proposes a five-person Board for NASD Dispute Resolution, consisting of three non-industry and two industry directors, as those terms and defined in Article I of the proposed By-Laws. The Chief Executive Officer of the NASD will be an ex-officio non-voting member of the Board. The non-industry directors would include at least two persons who also are members of the NASD Board, and an additional person knowledgeable in the dispute resolution field. At least one of the non-industry directors also will qualify as a public director, as defined in the By-Laws. One industry director would be a member of the NASD Board; the other would be the President of the new subsidiary. The NASD Board would elect the directors, as is done for the members of the other subsidiary boards.

The procedures currently in place for disciplining members and associated persons for noncompliance with arbitration awards will continue much as they are at present. The Code of Arbitration Procedure, in IM-10100, provides that the failure of a member or associated person to comply with an arbitration award obtained in connection with an arbitration submitted for disposition pursuant to the procedures specified by the NASD, other self-regulatory organizations, or the American Arbitration Association⁶ may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110. This language presently applies to awards obtained in the NASD Regulation forum, since that forum applies rules and procedures that are ultimately approved by the NASD. This will also be the case for NASD Dispute Resolution. Enforcement of the Code will continue to be handled by NASD Regulation.

As is the case with actions by NASD Regulation, actions by the NASD Dispute Resolution Board may be referred by that Board to the NASD Board, or reviewed by the NASD Board, as provided in the proposed

amendments to the Delegation Plan.⁷ Thus, the rules utilized by NASD Dispute Resolution will be the rules of the Association, just as rules approved currently by the other subsidiaries and subject to NASD Board review are deemed to be NASD rules.

NASD Regulation has formed a working group with representatives from various departments to ensure a smooth transition.

The necessary amendments to create the new subsidiary, and certain technical changes, are described in detail below.

Description of Proposed Amendments

The Plan of Allocation and Delegation of Functions by NASD to Subsidiaries ("Delegation Plan") is proposed to be amended to add references to the new subsidiary and to move the arbitration and mediation functions from NASD Regulation to NASD Dispute Resolution. Therefore, references to the delegations of authority to the subsidiaries and the rulemaking decisions of the subsidiaries have been amended to include references to NASD Dispute Resolution. As is the case for NASD Regulation and Nasdaq, actions of the new subsidiary Board will be subject to review by the NASD Board, and rule filings will be made by the new subsidiary on behalf of the NASD.

The description of the National Arbitration and Mediation Committee ("NAMC") in the Delegation Plan has been moved from the section concerning NASD Regulation to a new section concerning NASD Dispute Resolution. A change has been made in the NAMC member balancing requirement to provide more flexibility while maintaining at least 50% non-industry membership. The Delegation Plan currently provides that NAMC membership shall be equally between industry and non-industry members. It may be desirable, however, to have an odd number of members of the NAMC to avoid tie votes. Therefore, the provision has been amended to state that the NAMC shall have at least 50% non-industry members. This provides additional flexibility while maintaining a minimum of half non-industry members, in accordance with the spirit of the Delegation Plan.

The NASD Regulation By-Laws are proposed to be amended to add

references to NASD Dispute Resolution in the definitions sections.⁸

Rule 0120(b) is proposed to be amended to clarify that the term "Association" collectively means the NASD and its subsidiaries that are considered part of the self-regulatory organization; that is, the NASD, NASD Regulation, Nasdaq, and NASD Dispute Resolution.

Rule 101029a) of the Code of Arbitration Procedure is proposed to be amended to clarify that the new NASD Dispute Resolution Board will appoint members of the NAMC and name its chair. In addition, Rule 10102(a) is proposed to be amended to replace the phrase "a pool of arbitrators" with the more accurate phrase "rosters of neutrals," since the current rosters include both arbitrators and mediators (collectively referred to as "neutrals").

Rule 10102(b) is proposed to be amended to conform to current practice, in which the NAMC recommends to the Board certain rules and procedures to govern the conduct of arbitration and mediation matters, and does not unilaterally make such changes. In addition, the phrase "NASD Dispute Resolution" has been added before "Board" to clarify that recommendations will be made to that Board. As noted above, actions of the new subsidiary Board will be subject to review by the NASD Board.

Rule 10401 is proposed to be amended to replace the phrase "by the Association" with regard to designation of the Director of Mediation and replace it with "by the NASD Dispute Resolution Board," and to delete "Association's" as a modifier of "National Arbitration and Mediation Committee." Although the NASD and its subsidiaries are collectively referred to as the Association for self-regulatory purposes, the use of "Association" in this Rule may cause confusion in light of the new corporate structure and serves no useful purpose in the Rule. The term "of Arbitration" is proposed to be added after one instance of the word "Director" to distinguish it from the Director of Mediation. In addition, the reference to the "Board of Governors" has been changed to "NASD Dispute Resolution Board" to reflect the new structure.

Rule 10404 is proposed to be amended to change the term "NASD" to "Association" to be more inclusive in this instance because, as described above, the term "Association" refers to the entire self-regulatory organization.

⁶The NASD Regulation Board of Directors recently approved an amendment to this Interpretive Material that would add, "or other dispute resolution forum selected by the parties." See Exchange Act Release No. 41339 (April 28, 1999), 64 FR 23887 (May 4, 1999). This proposal was filed as a non-controversial filing. The NASD designated May 17, 1999 as the effective date of the proposal.

⁷The Delegation Plan was amended in 1997, together with related By-Laws changes designed to allow the NASD Board to take action on its own initiative rather than waiting for a subsidiary to act on the matter. See Exchange Act Release No. 39326 (Nov. 14, 1997), 62 FR 62385 (Nov. 21, 1997).

⁸The NASD also intends to review the NASD and Nasdaq By-Laws and consider appropriate amendments to recognize of NASD Dispute Resolution.

The proposed NASD Dispute Resolution By-Laws are modeled on those of NASD Regulation, with modifications, described below, appropriate to the particular functions of NASD Dispute Resolution. For example, NASD Dispute Resolution will not require that a committee other than the NAMC review all rulemaking proposals. Similarly, there is no need for provisions on nominations and elections, as all NASD Dispute Resolution Board members will be selected by the NASD Board of Governors. Standard provisions allowing for the appointment of an Executive Committee and a Finance Committee have been included for flexibility, although it is not immediately expected that such committees will be needed.

Proposed Article IV, Section 4.2 sets the number of Board members at five to eight although, as stated above, the intention initially is to have only five Board members. In addition, the Chief Executive Officer of the NASD will be an ex-officio non-voting member of the Board. Proposed Section 4.3(a) provides that the number of non-industry directors shall equal or exceed the number of industry directors plus the President. This means that the President is treated as an industry director for this purpose. The other industry director and at least two of the non-industry directors also will be sitting members of the NASD Board. This overlapping membership provides stability and uniformity among the corporations. At least one of the non-industry directors also will qualify as a public director. The proposed By-Laws define "Public Director" as a director who has no material business relationship with a broker or dealer or the NASD, NASD Regulation, Nasdaq, or NASD Dispute Resolution. The By-Laws define "Non-Industry Director" as a director (excluding the President) who is (1) a public director or public member; (2) an officer or employee of an issuer of securities listed on Nasdaq or Amex, or traded in the over-the-counter market; or (3) any other individual who would not be an industry director or industry member.

A minor modification was made to the standard terminology in Section 4.13(h) to clarify that the Board may appoint a non-director to a committee, since this power is implied but not specifically stated in the preceding paragraphs of Section 4.13.

2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of

the Act,⁹ which requires, among other things, that the Association's rules 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 Regulation believes that the proposed rule change will protect the public interest by providing a sharper focus on the dispute resolution process and maintaining Commission oversight of that process.

Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation 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.

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

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, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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 File No. SR-NASD-99-21 and should be submitted by July 8, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41504; File No. SR-NSCC-98-14]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Ceasing To Act for a Member

June 9, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on December 8, 1998, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change, as described in Items I, II, and III below, which items have been prepared primarily by NSCC. 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

The proposed rule change will amend NSCC's rules to eliminate the distinction between those instances where NSCC ceases to act on behalf of a member as a result of the member's insolvency or for another reason and to permit NSCC to complete certain open receipt versus payment and delivery versus payment transactions ("RVP/DVP transactions").

¹⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

⁹ 15 U.S.C. 78o-3(b)(6).