SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51325; File No. SR-NASD-2005-007)

March 7, 2005

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to a Proposal to Adopt a New IM-10308 on Mediators Serving as Arbitrators

I. Introduction

On January 19, 2005, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to adopt a new Interpretive Manual ("IM")-10308 on mediators serving as arbitrators. The proposed rule change was published for comment in the Federal Register on February 3, 2005.[3] The Commission received one comment letter on the proposed rule change.[4] For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

A. Description of the Proposal

NASD proposed to adopt a new IM-10308 to clarify that (1) fees for service as a mediator are not included in determining whether an attorney, accountant, or other professional derives

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 51097 (Jan. 28, 2005), 70 FR 5715 (Feb. 3, 2005) (the "Notice").

4 See Letter to Jonathan Katz, Secretary, Commission, from George R. Kramer, Deputy General Counsel, Securities Industry Association ("SIA"), dated February 25, 2005 ("SIA Letter").

10% of his or her annual revenue from industry-related parties; and (2) service as a mediator is not included in determining whether an attorney, accountant, or other professional devotes 20% or more of his or her professional work to securities industry clients. Recent changes to NASD's arbitrator classification rules amended the definitions of "public" and "non-public" arbitrators (non-public arbitrators have some current or recent connection with the securities industry, but do not necessarily work in the industry).[5] The changes led, among other things, to reclassifying some arbitrators from public to non-public or from non-public to public, and to dropping some arbitrators from the NASD's roster. One new part of the rule provided that arbitrators who were otherwise qualified as public could not continue to serve as public arbitrators if their firms derived more than 10% of their revenue from industry parties.[6]

Some arbitrators who also serve as mediators were of the opinion that the rule change encompassed income in the form of mediation fees paid by industry parties such that these individuals would no longer qualify as public arbitrators under the new rule. The NASD Dispute Resolution Board determined that the rule could be construed broadly enough to cover revenue derived from serving as a mediator but that such a broad interpretation was not intended. The proposed rule change would adopt a clarifying IM that would be printed in the Code following Rule 10308. The IM provides, in part, that mediation fees received by mediators who are also arbitrators are not to be included in the definition of "revenue;" that mediation services performed by mediators who are also arbitrators are not to be included in the definition of

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5 See Exchange Act Release No. 49573 (Apr. 16, 2004), 69 Fed. Reg. 21871 (Apr. 22, 2004) (SR-NASD-2003-095).

6 For further detail, see the Notice, note 3, supra.

"professional work;" and that arbitrators who also serve as mediators must disclose that information.

B. Comment Summary

The proposal was published for comment in the Federal Register on February 3, 2005.[7] We received one comment on the proposal,[8] which was supportive. Citing confusion arising from the implementation of the NASD's 2004 changes to the arbitrator classification rules, the commenter agreed with the NASD Dispute Resolution Board that the rules should not be construed to cover revenues or work deriving from service as a mediator. The commenter accordingly called the proposed rule change appropriate.

III. Discussion and Findings

The Commission finds the proposed rule change is consistent with the Act, and in particular with Section 15A(b)(6) of the Act, which requires, among other things, that NASD'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.[9] The Commission believes that the proposed rule change is consistent with the provisions of the Act noted above because it provides clarity to the operation of the rules regarding arbitrator classification and addresses an ambiguity in the interpretation of the arbitrator classification rules. The Commission believes that this clarification of the arbitrator rules will increase efficiency in the operation of the arbitrator selection process, as well as provide additional useful disclosure to claimants regarding an arbitrator's service as a mediator.

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7 See note 3, supra.

8 See note 4, supra.

9 15 U.S.C. 78o-3(b)(6).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act[10] that the proposed rule change (SR-NASD-2005-007) be, and hereby is, approved. [11]

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[12]

Margaret H. McFarland
Deputy Secretary

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10 15 U.S.C. 78s(b)(2).

11 In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

12 17 CFR 200.30-3(a)(12).