

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-49636; File No. SR-NASD-2003-69)**

**April 30, 2004**

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding Failure to Pay Arbitration Awards**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 7, 2003, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On March 5, 2004, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

NASD is proposing to (1) amend Article V, Section 4 of the NASD By-Laws to permit NASD to suspend for failure to pay an arbitration award or settlement, for a period of two years after the award is entered, former associated persons who terminated their registration before the award was entered; and (2) amend Article VI, Section 3 of the NASD By-Laws to clarify that NASD may suspend the association, and not just the registration, of any person who fails to pay an arbitration award. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in [brackets].

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

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

<sup>3</sup> See letter from Kosha K. Dalal, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated March 5, 2004.

**Article V**

**REGISTERED REPRESENTATIVES AND ASSOCIATED PERSONS**

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**Retention of Jurisdiction**

**Sec. 4. (a)** A person whose association with a member has been terminated and is no longer associated with any member of [the] NASD or a person whose registration has been revoked or canceled shall continue to be subject to the filing of a complaint under the NASD Rules [of the Association] based upon conduct [which] that commenced prior to the termination, revocation, or cancellation or upon such person's failure, while subject to [the] NASD's jurisdiction as provided herein, to provide information requested by [the] NASD pursuant to the NASD Rules [of the Association], but any such complaint shall be filed within:

[ (a) ] (i) two years after the effective date of termination of registration pursuant to Section 3, provided, however that any amendment to a notice of termination filed pursuant to Section 3(b) that is filed within two years of the original notice [which] that discloses that such person may have engaged in conduct actionable under any applicable statute, rule, or regulation shall operate to recommence the running of the two-year period under this subsection;

[ (b) ] (ii) two years after the effective date of revocation or cancellation of registration pursuant to the NASD Rules [of the Association]; or

[ (c) ] (iii) in the case of an unregistered person, [within] two years after the date upon which such person ceased to be associated with the member.

(b) A person whose association with a member has been terminated and is no longer associated with any member of NASD shall continue to be subject to a proceeding to suspend,

consistent with Article VI, Section 3 of the By-Laws, his or her ability to associate with a member based on such person's failure to comply with an arbitration award or a written and executed settlement agreement obtained in connection with an arbitration or mediation submitted for disposition pursuant to the NASD Rules, provided that such proceeding is instituted within two years after the date of entry of such award or settlement.

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## **Article VI**

### **DUES, ASSESSMENTS, AND OTHER CHARGES**

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#### **Suspension or Cancellation [of Membership or Registration]**

**Sec. 3. (a)** [The] NASD after 15 days notice in writing, may suspend or cancel the membership of any member or the registration of any person in arrears in the payment of any fees, dues, assessments, or other charges or for failure to furnish any information or reports requested pursuant to Section 2 [, or for failure to comply with an award of arbitrators properly rendered pursuant to the Rules of the Association, where a timely motion to vacate or modify such award has not been made pursuant to applicable law or where such a motion has been denied, or for failure to comply with a written and executed settlement agreement obtained in connection with an arbitration or mediation submitted for disposition pursuant to the Rules of the Association].

(b) NASD after 15 days notice in writing, may suspend or cancel the membership of any member or suspend from association with any member any person, for failure to comply with an award of arbitrators properly rendered pursuant to the NASD Rules, where a timely motion to vacate or modify such award has not been made pursuant to applicable law or where such a

motion has been denied, or for failure to comply with a written and executed settlement agreement obtained in connection with an arbitration or mediation submitted for disposition pursuant to the NASD Rules.

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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 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

1. Purpose

Amendment Regarding Former Associated Persons Who Fail to Pay Arbitration Awards

Article VI, Section 3 of the NASD By-Laws (Dues, Assessments and Other Charges) allows NASD to seek suspensions or cancellations for failure to comply with an award or settlement agreement relating to an arbitration or mediation.<sup>4</sup> If a person becomes subject to an arbitration award or enters into a settlement agreement in arbitration while associated with a member, then terminates his or her association with the member before paying the arbitration award or settlement, NASD may bring an action against that former associated person based on his or her failure to pay. Such actions are permissible because Article V, Section 4 of the NASD By-Laws (Retention of Jurisdiction) provides that a person whose association with a member has

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<sup>4</sup> The Rule 9510 Series describes the process by which NASD may suspend or cancel the membership of any member or the registration of any person for failure to pay an arbitration award or settlement agreement executed in connection with an arbitration or mediation occurring under NASD Rules.

terminated continues to be subject to NASD proceedings based on conduct that began before the termination, provided such proceeding is brought within two years after the termination. The word “termination” as used in Article V, Section 4 shall mean the following: (1) when applied to associated persons who are registered with NASD, that time when a Form U5 with respect to such person is filed with NASD; or (2) when applied to associated persons who are not registered with NASD, that time when such person ceases to be associated with a member, regardless of whether, in the case of (1) or (2), such termination is voluntary or involuntary, or with or without cause.

In 1998, the NASD Board of Governors directed the Office of Hearing Officers to dismiss, for lack of jurisdiction, a proceeding alleging failure to pay an arbitration award against a person who terminated his association after the arbitration proceeding commenced but before an arbitration award was entered against him.<sup>5</sup> The Board held that because the conduct underlying the proceeding (i.e. the failure to pay an arbitration award) did not begin until after the person’s association terminated, NASD did not have jurisdiction over the person under Article V, Section 4 of NASD By-Laws.

NASD is concerned that a person associated with a member will terminate his or her association with the member once aware that an arbitration award may be entered against him or her in order to avoid sanction by NASD for failure to pay any award or settlement agreement resulting from the proceeding. Accordingly, the proposed rule change provides that for the limited purpose of instituting proceedings for failure to pay arbitration awards or settlements, NASD retains, for a period of two years after the entry of the award or settlement, jurisdiction to impose suspensions against former associated persons if the award or settlement resulted from a

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<sup>5</sup> See Department of Enforcement v. Jonathan Winston, Non-Summary Proceeding No. ARB980006 (Office of Hearing Officers, December 15, 1998).

claim submitted for arbitration or mediation pursuant to the NASD Rules. Suspending these persons will prevent them from re-entering the industry until the award is paid. Proposed Subsection 4(b) does not limit in any manner the authority of NASD to act pursuant to Subsection 4(a).

Amendment Regarding Sanctions Against Associated Persons Who Fail to Pay Arbitration Awards

The Rule 9510 Series, which provides a procedural framework for actions taken pursuant to Article VI, Section 3 of the NASD By-Laws, states that NASD may seek a suspension or cancellation for failure to comply with an award or settlement agreement relating to an arbitration or mediation pursuant to Article VI, Section 3 of the NASD By-Laws. Article VI, Section 3 specifies that NASD may suspend or cancel the registration of any person for failure to comply with arbitration awards or settlements. Persons suspended from registration with NASD for failing to pay arbitration awards arguably may seek to associate with member firms in unregistered capacities. NASD proposes amending Article VI, Section 3 of the NASD By-Laws to clarify that NASD may suspend any person from associating with a member in any capacity for failure of such person to comply with an arbitration award or settlement.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>6</sup> which requires, among other things, that NASD 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. Specifically, the proposed rule change strengthens NASD's ability to prevent persons who fail to honor securities-related arbitration awards from seeking to re-enter the securities business, and clarifies that persons who

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<sup>6</sup> 15 U.S.C. 78o-3(b)(6).

fail to honor such awards may be suspended from associating with NASD members in any capacity.

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. NASD issued Notice to Members 03-04 on January 10, 2003 soliciting its members to vote on the proposed rule change. NASD members approved the proposed rule change by vote completed on February 10, 2003.

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. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2003-69.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2003-69. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You



should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2003-69 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).