

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51097; File No. SR-NASD-2005-007)

January 28, 2005

Self-Regulatory Organizations; Notice of Filing of 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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that 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 (“Commission” or “SEC”) the proposed rule change as described in Items I, II, and III, below, which NASD has prepared. 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 adopt a new Interpretive Material (“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 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. The text of the proposed rule change is reproduced below. Proposed new language is in italics.

* * * * *

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

IM-10308. Arbitrators Who Also Serve as Mediators³

Mediation services performed by mediators who are also arbitrators shall not be included in the definition of “professional work” for purposes of Rule 10308(a)(4)(C), so long as the mediator is acting in the capacity of a mediator and is not representing a party in the mediation.

Mediation fees received by mediators who are also arbitrators shall not be included in the definition of “revenue” for purposes of Rule 10308(a)(5)(A)(iv), so long as the mediator is acting in the capacity of a mediator and is not representing a party in the mediation.

Arbitrators who also serve as mediators shall disclose that fact on their arbitrator disclosure forms.

* * * * *

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

³ This IM will be renumbered following Commission approval of the pending revisions of the Customer and Industry Codes, SR-NASD-2003-158, filed on October 15, 2003, and SR-NASD-2004-011, filed on January 20, 2004.

Several rule changes relating to arbitrator classification were approved by the SEC⁴ on April 16, 2004 and implemented by NASD on July 19, 2004. These changes 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). In the course of implementing the classification rule, NASD surveyed its entire roster of arbitrators, asking questions that tracked the new definitions. In light of information contained in their responses, some arbitrators were reclassified from public to non-public or from non-public to public, and some arbitrators were dropped from the roster for various reasons.

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. Specifically, Rule 10308(a)(5)(A)(iv) of the Code of Arbitration Procedure was amended to read as follows:

The term “public arbitrator” means a person who is otherwise qualified to serve as an arbitrator and...(iv) is not an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past 2 years from any persons or entities listed in paragraph (a)(4)(A)....

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, although this was

⁴ See Exchange Act Release No. 49573 (Apr. 16, 2004), 69 Fed. Reg. 21871 (April 22, 2004) (SR-NASD-2003-095).

clearly not the intent of the recent rule changes, and unanimously voted to issue a clarification in an IM that would be printed in the Code following Rule 10308.

The IM also would make clear that mediation services performed by mediators who are also arbitrators is not to be included in the definition of “professional work” for purposes of the 20% test either, so long as the mediator is acting in the capacity of a mediator and is not representing a party in the mediation.

In considering this matter, the NASD Dispute Resolution Board also determined that parties may wish to know that an arbitrator on their list also serves as a mediator and may be familiar with the industry parties or their counsel. NASD staff will add this information to the disclosure forms of dual arbitrators/mediators.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁵ which requires, among other things, that the NASD’s rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that any potential conflict is best addressed by ensuring that arbitrators who are mediators disclose this fact in the arbitrator disclosure history. NASD will prepare materials to inform arbitrators of the need to make this disclosure.

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

NASD Regulation does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the Act.

⁵ 15 U.S.C. 78q-3(b)(6).

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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. Please include File Number SR-NASD-2005-007 on the subject line.

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-2005-007. 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 Room. 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-2005-007 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.⁶

Margaret H. McFarland
Deputy Secretary

⁶ 17 CFR 200.30-3(a)(12).