

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51339; File No. SR-NASD-2004-164)

March 9, 2005

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by National Association of Securities Dealers, Inc. Relating to the Random Selection of Arbitrators by the Neutral List Selection System

On October 28, 2004, the National Association of Securities Dealers, Inc. (“NASD”), through its subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”), submitted to 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 NASD Rule 10308 of the NASD Code of Arbitration Procedure (“Code”). On January 5, 2005, NASD filed Amendment No. 1 to the proposed rule change.³ The Federal Register published the proposed rule change, as amended, for comment on February 2, 2005.⁴ The Commission received four comment letters in response to the proposed rule change.⁵ This order approves the proposed rule change, as amended.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Mignon McLemore, NASD, to Catherine McGuire, SEC, dated January 5, 2005. In this letter, NASD stated that it will hire an outside consultant to audit the random selection system after it has been operational for one year and independently verify that the random selection system is operating as described in the proposed rule change. NASD also stated that it will keep statistics on the arbitrators selected by the random selection system who appear on an arbitrator list in order to monitor the effectiveness of the random selection system.

⁴ Securities Exchange Act Release No. 51083, 70 FR 5497 (“Notice”).

⁵ See letters to Jonathan Katz, Secretary, Commission, from Les Greenberg, dated February 10, 2005 (“Greenberg letter”); Arnold Levine, dated February 19, 2005 (“Levine letter”); Philip Zimmerman, dated February 21, 2005 (“Zimmerman letter”); and Irwin Sugerma, dated February 21, 2005 (“Sugerma letter”).

The proposed amendment to NASD Rule 10308 would change the method used by the Neutral List Selection System (“NLSS”) to select arbitrators from a rotational to a random selection function by incorporating the random selection provision of the proposed Customer and Industry Code revisions.⁶

The Greenberg letter supported the change to a random selection system. The Sugerma letter commented that a rotational system is more fair, asserting that under such a system an arbitrator’s name is presented for possible selection with the same frequency as every other arbitrator. The Zimmerman letter suggested that NASD also use a random selection function for selecting mediators. The Levine letter, while addressing issues relating to arbitrators, did not specifically address the change from a rotational to a random arbitrator selection system.⁷

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.⁸ In particular, the Commission believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,⁹ which requires, among other

⁶ NASD Dispute Resolution has filed with the SEC a proposed rule change to the Code to reorganize the current rules, simplify the language, codify current practices, and implement several substantive changes. The rule filing was submitted in three parts: Customer Code, Industry Code, and Mediation Code. The Customer Code was filed on October 15, 2003, and amended on January 3, 2005 and January 19, 2005 (SR-NASD-2003-158); the Industry Code was filed on January 16, 2004, and amended on February 26, 2004 and January 3, 2005 (SR-NASD-2004-011). The Mediation Code was filed on January 23, 2004, and amended on January 3, 2005 (SR-NASD-2004-013). It does not contain any provisions concerning the NLSS. The three new codes will replace the current Code in its entirety. The Code revision is undergoing SEC staff review and has not yet been published for comment.

⁷ The Levine letter commented that NASD should only use professional arbitrators and suggested qualifications that should be required of such arbitrators.

⁸ 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. 78(c)(f).

⁹ 15 U.S.C. 78q-3(b)(6).

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. The Commission believes that a random selection function incorporated into the NASD Dispute Resolution arbitration forum provides a fair and equitable system for parties to select arbitrators.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-NASD-2004-164), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Jill M. Petersen
Assistant Secretary

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).