Notices to Members
YEAR 2000 UPDATE
NASD ®
NASDAQ AMEX
NASD
REGULATION
December 1999

SEC—Year 2000 Recordkeeping Rule

Effective August 31, 1999, the Securities and Exchange Commission (SEC) adopted SEC Rule 17a-9T (the Rule) relative to Year 2000. The Rule, which was originally proposed in March 1999, is intended to assist broker/dealers, the SEC, self-regulatory organizations (SROs), and the Securities Investor Protection Corporation (SIPC) in identifying all securities positions carried by a broker/dealer and the location of the securities in the event that a broker/dealer experiences Year 2000 problems.

Following are the key components of the Rule:

- It applies to all registered broker/dealers that carry customer accounts and that have a minimum net capital requirement of $250,000.

- The Rule requires that before January 1, 2000, all subject broker/dealers must make certain records for the three-day period from Wednesday, December 29, 1999, through Friday, December 31, 1999, as follows:
  1) separate blotters as required by SEC Rule 17a-3(a)(1); and
  2) separate copies of the securities record or ledger as required by SEC Rule 17a-3(a)(5).

- The records generated pursuant to the Rule must be maintained for not less than one year and can be maintained in any medium acceptable under SEC Rule 17a-4(f).

The importance of these records is paramount in the event of Year 2000 problems. All potentially subject firms should review the Rule immediately and take any internal steps necessary to make sure that the recordkeeping requirements of the Rule can be complied with in the time allotted.

To The Members: Thank You

The National Association of Securities Dealers, Inc. (NASD®) Year 2000 Program Office, and the NASD and its subsidiaries, would like to convey to the entire membership our thanks for your efforts and hard work in meeting the requirements administered by the SEC, NASD, and other SROs. In every aspect, you have done an outstanding job. We particularly feel that your work in preparing for the Year 2000 transition has been critical to the industry's readiness efforts. Again thank you for your efforts and participation. We wish you a wonderful holiday season and successful new year.

NASD Regulation To Require Certain Firms To File FOCUS Reports And Reg T Extension Requests Manually In The Event Of Year 2000 Problems

NASD Regulation℠ and its broker/dealer members have separately developed comprehensive Year 2000 Business Continuity Plans designed to provide, among other things, alternative ways for NASD Regulation and members to perform critical business functions in the event that normal methods have been disabled by Year 2000-induced disruptions or events. As part of this effort, the Member Regulation Department of NASD Regulation has developed plans to accept manually filed December 1999 FOCUS Reports (due to be filed on or before January 26, 2000) from specifically designated firms. The designated firms and the manual process are described below. In addition, all members should be prepared to file Reg T extension requests manually if Year 2000 problems prevent electronic transmission. Details on both of these contingencies follow.

December FOCUS Reports

The SEC is requiring that certain broker/dealers submit completed Millennium Transition Questionnaires (MTQ) to their designated examining authority. Approximately 220 NASD member firms will be required to submit MTQs to the NASD during the period of December 29, 1999 through January 7, 2000. The information provided on MTQs will be reported to the SEC and used by NASD Regulation to supplement normal regulatory information for the purpose of identifying and assisting firms that may encounter financial or operational problems resulting from Year 2000-related events and to most effectively protect the investing public.

The FOCUS report is an essential part of Member Regulation's financial monitoring program. As such, it is important to ensure that Member Regulation receive these reports even in the event that Year 2000 problems prevent electronic transmission. Accordingly, Member Regulation will require all member firms subject to MTQ reporting to manually file the December 1999 FOCUS Report if: a) the firm encounters system or operational problems that prevent it from making a timely electronic filing; or b) the NASD notifies the firm or makes a general announcement (via the NASD or NASD Regulation Web Sites or otherwise) that Year 2000-related problems have impacted the NASD's ability to receive and process this data electronically. The manual filing, if required, will be due under the normal time frames specified in SEC Rule 17a-5. Any required manual FOCUS filing will be submitted to the local District Office and Member Regulation's Systems Support, Attention: Eleanor Sabalbaro, 1399 Piccard Drive, 3rd floor, Rockville, Maryland 20850.

Reg T Extension Requests

Regulation T of the Federal Reserve Board allows, with certain limitations, a broker/dealer to request an extension of time for payment to enable a customer to meet his/her obligation in either a cash or margin account.

Member Regulation will require all member firms that need to file for an extension of time under Regulation T of the Federal Reserve Board to file manually with the local District Office in the event that: a) the firm encounters system or operational problems that prevent it from making a timely electronic filing; or b) the NASD notifies the firm or makes a general announcement (via the NASD or NASD Regulation Web Sites or otherwise) that Year 2000-related problems have impacted the NASD's ability to receive and process these requests electronically.

If not already included in Year 2000 contingency plans, member firms are encouraged to take steps now to ensure that they are able to comply with any manual filing requirements that may be necessary. Among other precautions, we suggest that members print paper versions of both the FOCUS report and the Regulation T extension request form from the NASD Regulation Web Site.

Any questions regarding FOCUS or Regulation T filings may be directed to Sam Luque (202-728-8472) or Susan DeMando (202-728-8411) in the Member Regulation Department.

Testing And Continuing Education

NASD Regulation has taken exceptional steps to ensure the Year 2000 integrity of its processes, software, and systems. One area that is recognized as critically important is the certification of registered persons. NASD Regulation is confident that all appropriate steps have been taken to ensure, to the greatest extent possible, that the NASD Regulation PROCTOR® System, which is responsible for the administration of testing and continuing education to the securities industry, will not be adversely impacted by Year 2000 disruptions.

To prepare for unexpected Year 2000-related events, NASD Regulation has developed contingency plans to handle matters outside of its control. It is possible that isolated problems may occur in some delivery locations. We cannot rule out more extensive Year 2000 disruptions to the infrastructure. To prepare for such possibilities, however remote, NASD Regulation has conferred with Sylvan Prometric, its test delivery contractor, to review alternatives.

If, as the result of Year 2000-related problems experienced by NASD Regulation or Sylvan, a candidate is not able to schedule or take a qualifications examination or continuing education session, the candidate's expiration date will be automatically extended. The candidate will need to contact Sylvan Prometric to reschedule his/her session after January 15th and complete that session within 60 days of his/her initial expiration date. Paper and pencil versions of a limited subset of certification tests will be pre-staged by NASD Regulation. In the event of a critical need, these will be distributed to selected Sylvan Testing Centers for delivery.

Please direct any questions concerning qualifications examinations to Lee Hays (301-590-6003) and continuing education inquires to John Linnehan (301-208-2932) in the Member Regulation Department.

Advertising Regulation

Members that are unable to file their advertisements and sale literature with the NASD Advertising Regulation Department or that are unable to perform their compliance activities as a result of Year 2000-related problems, are required to communicate their situation to the Department. The Department staff will work with members in seeking alternative ways to review sales material internally and submit required filings.

If members have any questions they should contact Thomas A. Pappas, Director, Advertising/Investment Companies Regulation Department at (202) 728-8330.

More Information/Questions

NASD Year 2000 Program Office
e-mail: *y2k@nasd.com*
phone: (888) 227-1330

or visit the Year 2000 Web Pages:
www.nasd.com
www.nasdr.com

INFORMATIONAL

Employment Arbitration Rules

SEC Approves New Arbitration Disclosure Rule And Procedures For Employment Arbitration; **Effective Date: January 18, 2000**

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Registered Representatives

KEY TOPICS

- Arbitration
- Discrimination
- Employment

Executive Summary

On October 27, 1999, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD®) rules that create a new Rule 10210 Series, containing special rules applicable to the arbitration of employment discrimination claims; add a new Rule 3080, which contains a model disclosure statement to be given to persons who are signing the Form U-4 to apply for registration; and make conforming changes to Rules 10201 and 10202.[1] These rule changes, which will become effective on January 18, 2000, will enhance the dispute resolution process for the handling of employment discrimination claims and expand disclosure to employees concerning the arbitration of disputes.

Included with this *Notice* is Attachment A, the text of the amendments that will become effective on January 18, 2000.

Questions/Further Information

Questions regarding this *Notice* may be directed to Linda D. Fienberg, Executive Vice President, Office of Dispute Resolution, NASD Regulation, Inc. (NASD Regulation℠), at (202) 728-8407; George H. Friedman, Senior Vice President and Director, Office of Dispute Resolution, NASD Regulation, at (212) 858-4488; or Jean I. Feeney, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-6959.

Background

Effective on January 1, 1999, the NASD removed from the Code of Arbitration Procedure (Code) the requirement for registered persons to arbitrate claims of statutory employment discrimination.[2] In approving that change to Rule 10201, the NASD Board of Governors and the NASD Regulation Board of Directors (the Boards) recommended certain enhancements to the arbitration process for discrimination claims. With the assistance of a working group that included attorneys representing employees, member firm general counsels, and arbitrators with expertise in employment matters to advise on issues relating to the arbitration of employment discrimination claims, NASD Regulation developed a series of rules applicable to the arbitration of statutory employment discrimination claims, and related changes to other NASD rules. These rules, as adopted by the Boards and approved by the SEC, deal with the qualifications of arbitrators hearing claims of employment discrimination; the number of arbitrators to hear such claims; special rules for discovery, awards, and attorneys' fees; coordination of claims filed in court and arbitration; and disclosure to associated persons of the effects of the arbitration clause found in the Form U-4. The new rules are described in detail below.

Description Of Amendments

Disclosure Statement

NASD Regulation has adopted a model disclosure statement to be given to persons who are signing the Form U-4 to apply for registration. This disclosure statement explains the nature and effect of the arbitration clause contained in the Form U-4. It does not address any private arbitration agreement that the applicant might enter into with the member firm. Rather, the member is responsible for either making proper disclosure to its employees about its private arbitration agreement, or risking an adverse decision in later litigation concerning any inadequacy in the disclosure.

New Rule 3080, entitled "Disclosure to Associated Persons When Signing a Form U-4," is modeled on the disclosure given to customers when signing predispute arbitration agreements with member firms, as contained in current Rule 3110(f) and proposed amendments thereto that are awaiting SEC approval.[3] Because the rule relates to associated persons, it has been located with other conduct rules that deal with the responsibilities of members relating to associated persons, employees, and other employees. The introductory language of the rule requires members to provide each associated person, whenever the associated person is asked to sign a new or amended Form U-4, with certain specified disclosure language. This means that the disclosure may be given by the same member to the same associated person on more than one occasion during that person's employment, if the associated person has reason to re-sign the Form U-4. The specified disclosure language explains that the Form U-4 contains a predispute arbitration clause, and indicates in which item of the Form U-4 the clause is located.[4] The disclosure language then advises the associated person to read the predispute arbitration clause.

Subparagraph (1) of new Rule 3080 paraphrases the arbitration clause in the Form U-4 and then provides disclosure that the associated person is giving up the right to sue in court except as provided by the rules of the arbitration forum in which a claim may be filed. Subparagraph (2) incorporates the language of Rule 10201 regarding an exception to the arbitration requirement for claims of statutory employment discrimination. Subparagraph (2) also indicates that the rules of other arbitration forums may be different. Subparagraphs (3) through (7) track the language of proposed amendments to Rule 3110(f)(1), which sets forth similar disclosures to customers. Those subparagraphs inform the associated person that arbitration awards are generally final and binding, that discovery is generally more limited in arbitration than in court, that arbitrators do not have to explain the reasons for their awards, that the panel of arbitrators may include either public or industry (non-public) arbitrators, and that the rules of some arbitration forums may impose time limits for bringing a claim in arbitration.

New Rule 10210 Series

The new Rule 10210 Series contains special rules applicable to statutory employment discrimination claims. These rules supplement and, in some instances, supersede the provisions of the Code that currently apply to the arbitration of employment disputes. The special rules do not attempt to set forth all procedures applicable to the arbitration of statutory employment discrimination claims. but only those procedures that relate specifically to such claims and may be different from procedures that apply to other intra-industry claims.

Qualifications For Neutrals Who Hear Employment Discrimination Cases

NASD Regulation has on its arbitration roster many arbitrators who have indicated that they have experience or training in employment law, and NASD Regulation currently offers arbitrators training in employment law that is conducted by attorneys experienced in the field of employment law. In addition, NASD Regulation has been preparing a more specialized roster of available arbitrators for intra-industry cases in which statutory discrimination is alleged. As of November 1999, over 200 arbitrators have been placed on this specialized roster.

New Rule 10211(a) provides that only arbitrators classified as public (non-industry) arbitrators will be selected to consider disputes involving a claim of employment discrimination, including a sexual harassment claim, in violation of a statute. New Rule 10211(a) incorporates by reference the definition of "public arbitrator" in the list selection rule, Rule 10308, which applies both to customer disputes and to intra-industry disputes except where superseded by more specific industry arbitration rules. The definition of "public arbitrator" in Rule 10308 excludes not only securities industry employees and their immediate family members, but also attorneys, accountants, and other professionals who have devoted 20 percent or more of their professional work in the last two years to clients who are engaged in the securities business (as described in Rule 10308). Use of the same definition of public arbitrators throughout the Code provides for more efficient administration of the list selection system.

For chairpersons and single arbitrators, there are additional qualifications in new Rule 10211(b). These qualifications include:

- a law degree;
- membership in the Bar of any jurisdiction;
- substantial familiarity with employment law; and
- ten or more years of legal experience that include at least five years of one of the following:
  - law practice;
  - law school teaching;

- government enforcement of equal employment opportunity (EEO) statutes;
- experience as a judge, arbitrator, or mediator; or
- experience as an EEO officer or in-house counsel of a corporation.

In addition, the chair or single arbitrator may not have represented primarily the views of employees or employers within the past five years. For this purpose, "primarily" is defined to mean 50 percent or more of the arbitrator's business or professional activities within the last five years.

Rule 10211(c) provides that parties may agree, after a dispute arises, to waive any of the special qualifications contained in either paragraph (a) or paragraph (b). Such a waiver is not valid if it is contained in a predispute arbitration agreement.

Composition Of Panels

Until the present rule change, the current arbitration panel composition for statutory discrimination claims and certain other employment claims has been identical to the panel used for customer disputes and consists of either one public (non-industry) arbitrator for single arbitrator cases, or two public arbitrators and one non-public (industry) arbitrator for three arbitrator cases. An all-industry panel is used solely for employment disputes that relate exclusively to claims involving employment contracts, promissory notes, or receipt of commissions.

Under new Rule 10212(a), for cases involving claims of employment discrimination (whether or not other issues are also involved), all arbitrators must be classified as public. Rule 10212 provides, however, that parties may agree to a different panel composition in a particular case.

New Rule 10212(b) provides a higher maximum dollar limit for single arbitrator cases than is found elsewhere in the Code: a single arbitrator will hear claims of $100,000 or less. This higher amount reduces the hearing costs for the parties and results in more efficient allocation of qualified employment arbitrators. New Rule 10212(c) provides that claims for more than $100,000 will be assigned to a three-person panel unless the parties agree to have their case determined by a single arbitrator. A conforming amendment is being made to Rule 10202, the general intra-industry panel composition rule, to include a reference to the above special panel composition rule.

Discovery

New Rule 10213 provides that, in considering the need for depositions, arbitrators should consider the relevancy of the information sought from the persons to be deposed and the issues of time and expense. Existing Rule 10321, which deals with pre-hearing proceedings, is cross-referenced in new Rule 10213(b) to make clear that its provisions also apply to employment discrimination disputes. Paragraphs (d) and (e) of Rule 10321 set forth procedures for deciding unresolved issues either at the pre-hearing conference or by appointment of a selected arbitrator.

Attorneys' Fees

Although the Code is silent with respect to attorneys' fees, such fees may be awarded under current practice.[5] Normally, parties will brief the arbitrators on applicable law providing for the award of attorneys' fees in their cases. In view of provisions in the federal civil rights laws that specifically provide for the award of attorneys' fees, NASD Regulation has adopted Rule 10215, which provides that the arbitrator has authority to provide for reasonable attorneys' fee reimbursement, in whole or in part, as part of the remedy in accordance with applicable law. This accords with Title VII of the Civil Rights Act of 1964, which authorizes a court, in its discretion, to allow the prevailing party "a reasonable attorney's fee" as part of the costs.[6] The intent of new Rule 10215 is to allow the award of attorneys' fees if applicable law permits such an award.

Awards

Rule 10330(e) presently requires certain information to be contained in an award. Under current NASD Regulation practice, parties also may request the arbitrators to provide reasons for their decision, and the arbitrators have discretion to grant or deny the request.[7] New Rule 10214 has been added to supplement Rule 10330(e) for claims of employment discrimination. Rule 10214 provides that arbitrators will be empowered to award any relief that would be available in court under the law, and sets forth the information that must be contained in the arbitrator's award. Such information includes a summary of the issues, including the types of disputes, the damages or other relief requested and awarded, a statement of any other issues resolved, and a statement regarding the disposition of any statutory claims.

Bifurcation

NASD Regulation has added Rule 10216 to address concerns over the possible splitting or "bifurcation" of employment cases, in which the discrimination claims would proceed in court, while other employment claims that are subject to

mandatory arbitration would proceed in arbitration. Such bifurcation of statutory and common law claims could result in the separation of claims that are often joined together and based on the same alleged facts, which would create a financial burden on employees and members, delay the resolution of claims, and cause scheduling and discovery disputes.

Therefore, NASD Regulation has adopted a new rule on coordination of claims that may be filed in court and those that are normally required to be arbitrated under NASD rules. Currently, if the parties agree to resolve all related claims in court, then the matter need not be submitted to arbitration. New Rule 10216 includes a pre-filing procedure in which the claimant may certify to the Director of Arbitration that he or she communicated with the potential respondent about the possibility of filing all claims in court initially, in order to save the expense of arbitration fees and attorney fees to draft arbitration claim papers. If the potential respondent does not agree to consolidate all claims in court, and an arbitration claim is then filed, Rule 10216 provides several methods for coordinating claims filed in court and in arbitration. Similarly, if a discrimination claim is filed in court and related claims subject to mandatory arbitration are filed in arbitration, a respondent in the arbitration proceeding has the option to move to combine all claims in court. The rule provides several other opportunities for a party to move to compel that a claim be consolidated with other claims in court. Any claims not accepted by the court under any of these methods, however, would continue to be arbitrable.

In conjunction with the new bifurcation rule, a change has been made to Rule 10201 to add a reference to Rule 10216. This exception is necessary because, under Rule 10216, some claims that might otherwise be required to be arbitrated may be brought in court, at the respondent's option.

Endnotes

[1]Exchange Act Rel. No. 42061 (Oct. 27, 1999) (File No. SR-NASD-99-08), 64 Fed. Reg. 59815 (Nov. 3, 1999).

[2]That rule change did not affect private arbitration agreements that might exist between employees and member firms.

[3]File No. SR-NASD-98-74.

[4]The member will be responsible for updating this item number on new disclosure statements if it changes in later versions of the Form U-4.

[5]A guide for arbitrators drafted by the Securities Industry Conference on Arbitration (SICA) provides as follows: "Generally, parties to an arbitration are responsible for their personal costs associated with bringing or defending an arbitration action. Exceptions to the rule do exist. Parties should be prepared to argue the statutory or contractual basis that permits an award of attorneys' fees. The arbitrators should consider referring to the authority relied upon if attorneys' fees are awarded." *The Arbitrator's Manual* (October 1996). SICA is a group composed of representatives of the self-regulatory organizations (SROs) that provide arbitration forums; public investors; and the securities industry.

[6]42 U.S.C. Section 2000e-5(k) (1998).

[7]A booklet prepared by SICA and provided to all claimants explains this industry-wide practice as follows: "Arbitrators are not required to write opinions or provide reasons for the award. A party, however, may request an opinion. This request should be made no later than the hearing date." *Arbitration Procedures* (October 1996) (also available via the Internet under the title, *Arbitration Procedures for Investors*, on the NASD Regulation Arbitration/Mediation page at *www.nasdr.com*). In a 1989 Order approving arbitration rule changes by several SROs, the SEC decided not to require written opinions in awards but expressed the view that arbitrators could voluntarily prepare written opinions. Exchange Act Rel. No. 26805, Part III. H. (May 10, 1989) (File Nos. SR-NYSE-88-29, SR-NYSE-88-8, SR-NASD-88-29, SR-NASD-88-51, SR-NASD-89-19; and SR-AMEX-88-29), 54 Fed. Reg. 21144, 21151-52 (May 16, 1989).

ATTACHMENT A

Text Of Amendments

(Note: New text is underlined; deletions are in brackets.)

3000. RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS, EMPLOYEES, AND OTHERS' EMPLOYEES

* * *

3080. Disclosure to Associated Persons When Signing Form U-4

A member shall provide an associated person with the following written statement whenever the associated person is asked to sign a new or amended Form U-4.

The Form U-4 contains a predispute arbitration clause. It is in item 5 on page 4 of the Form U-4. You should read that clause now. Before signing the Form U-4, you should understand the following:

(1) You are agreeing to arbitrate any dispute, claim or controversy that may arise between you and your firm, or a customer, or any other person, that is required to be arbitrated under the rules of the self-regulatory organizations with which you are registering. This means you are giving up the right to sue a member, customer, or another associated person in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.

(2) A claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute is not required to be arbitrated under NASD rules. Such a claim may be arbitrated at the NASD only if the parties have agreed to arbitrate it, either before or after the dispute arose. The rules of other arbitration forums may be different.

(3) Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.

(4) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.

(5) The arbitrators do not have to explain the reason(s) for their award.

(6) The panel of arbitrators may include arbitrators who were or are affiliated with the securities industry, or public arbitrators, as provided by the rules of the arbitration forum in which a claim is filed.

(7) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

* * *

10000. CODE OF ARBITRATION PROCEDURE

* * *

10200. INDUSTRY AND CLEARING CONTROVERSIES

10201. Required Submission

(a) Except as provided in paragraph (b) or Rule 10216, a dispute, claim, or controversy eligible for submission under the Rule 10100 Series between or among members and/or associated persons, and/or certain others, arising in connection with the business of such member(s) or in connection with the activities of such associated person(s), or arising out of the employment or termination of employment of such associated person(s) with such member, shall be arbitrated under this Code, at the instance of:

(1) a member against another member;

(2) a member against a person associated with a member or a person associated with a member against a member; and

(3) a person associated with a member against a person associated with a member.

* * *

10202. Composition of Panels

(a) In disputes subject to arbitration that arise out of the employment or termination of employment of an associated person, and that relate exclusively to disputes involving employment contracts, promissory notes or receipt of commissions, the panel of arbitrators shall be appointed as provided by paragraph (b)(1) or (2) or Rule 10203, whichever is applicable. In all other disputes arising out of the employment or termination of employment of an associated person, the panel of arbitrators shall be appointed as provided by Rule 10212, 10302 or [Rule] 10308, whichever is applicable.

* * *

10210. Statutory Employment Discrimination Claims

The Rule 10210 Series shall apply only to disputes that include a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute. The

Rule 10210 Series shall supersede any inconsistent Rules contained in this Code.

10211. Special Arbitrator Qualifications for Employment Discrimination Disputes

(a) Minimum Qualifications for All Arbitrators

Only arbitrators classified as public arbitrators as provided in Rule 10308 shall be selected to consider disputes involving a claim of employment discrimination, including a sexual harassment claim, in violation of a statute.

(b) Single Arbitrators or Chairs of Three-Person Panels

(1) Arbitrators who are selected to serve as single arbitrators or as chairs of three-person panels should have the following additional qualifications:

(A) law degree (Juris Doctor or equivalent);

(B) membership in the Bar of any jurisdiction;

(C) substantial familiarity with employment law; and

(D) ten or more years of legal experience, of which at least five years must be in either:

(i) law practice;

(ii) law school teaching;

(iii) government enforcement of equal employment opportunity statutes;

(iv) experience as a judge, arbitrator, or mediator; or

(v) experience as an equal employment opportunity officer or in-house counsel of a corporation.

(2) In addition, a chair or single arbitrator with the above experience may not have represented primarily the views of employers or of employees within the last five years. For purposes of this Rule, the term "primarily" shall be interpreted to mean 50% or more of the arbitrator's business or professional activities within the last five years.

(c) Waiver of Special Qualifications

If all parties agree, after a dispute arises, they may waive any of the qualifications set forth in paragraph (a) or (b) above.

10212. Composition of Panels

For disputes involving a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute:

(a) Each panel shall consist of either a single public arbitrator or three public arbitrators qualified under Rule 10211, unless the parties agree to a different panel composition.

(b) A single arbitrator shall be appointed to hear claims for $100,000 or less.

(c) A panel of three arbitrators shall be appointed to hear claims for more than $100,000, unless the parties agree to have their case determined by a single arbitrator.

10213. Discovery

(a) Necessary pre-hearing depositions consistent with the expedited nature of arbitration shall be available.

(b) The provisions of Rule 10321 shall apply to proceedings under this Rule 10210 Series.

10214. Awards

The arbitrator(s) shall be empowered to award any relief that would be available in court under the law. The arbitrator(s) shall issue an award setting forth a summary of the issues, including the type(s) of dispute(s), the damages or other relief requested and awarded, a statement of any other issues resolved, and a statement regarding the disposition of any statutory claim(s).

10215. Attorneys' Fees

The arbitrator(s) shall have the authority to provide for reasonable attorneys' fee reimbursement, in whole or in part, as part of the remedy in accordance with applicable law.

10216. Coordination of Claims Filed in Court and in Arbitration

(a) Option to Combine Related Claims in Court

(1) (A) If a current or former associated person of a member files a statutory discrimination claim in court against a member or its associated persons, and asserts related claims in arbitration at the Association against some or all of the same parties, a respondent who is named in both proceedings shall have the option to move to compel the claimant to bring the related arbitration claims in the same court proceeding in which the statutory discrimination claim is pending, to the full extent to which the court will accept jurisdiction over the related claims.

(B) The respondent shall notify the claimant in writing, before the time to answer under Rule 10314 has expired, that it is exercising this option and shall file a copy of such notification with the Director. If the respondent files an answer without having exercised this option, it shall have waived its right to move to compel the claimant to assert related claims in court, except as provided in paragraph (b).

(2) (A) If a member or current or former associated person of a member ("party") has a pending claim in arbitration against a current or former associated person of a member and the current or former associated person thereafter asserts a related statutory employment discrimination claim in court against the party, the party shall have the option to assert its pending arbitration claims and any counterclaims in court.

(B) The party shall notify the current or former associated person in writing, before filing an answer to the complaint in court, that it is exercising this option and shall file a copy of such notification with the Director. If the party files an answer in court without having exercised this option, it shall have waived its right to assert the pending arbitration claim in court.

(C) The party may not exercise this option after the first hearing has begun on the arbitration claim.

(b) Option Extended When Claim is Amended

(1) If the claimant files an amended Statement of Claim adding new claims not asserted in the original Statement of Claim, a respondent named in the amended Statement of Claim shall have the right to move to compel the claimant to assert all related claims in the same court proceeding in which the statutory discrimination claim is pending, to the full extent that the court will accept jurisdiction over the related claims, even if those related claims were asserted in the original Statement of Claim.

(2) The respondent shall notify the claimant in writing, before the time to answer the amended Statement of Claim under Rule 10314 has expired, that it is exercising this option and shall file a copy of such notification with the Director. If the respondent files an answer to the amended Statement of Claim without having exercised this option, it shall have waived its right to move to compel the claimant to assert related claims in court.

(c) Requirement to Combine All Related Claims

If a party elects to require a current or former associated person to assert all related claims in court, the party shall assert in the same court proceeding all related claims that it has against the associated person to the full extent to which the court will accept jurisdiction over the related claims.

(d) Right of Respondent to Remain in Arbitration

(1) If there are multiple respondents and a respondent has exercised an option under paragraph (a) or (b), but another respondent wishes to have the claims against it remain in arbitration, then any remaining party may apply for a stay of the arbitration proceeding.

(2) The arbitration shall be stayed unless the arbitration panel determines that the stay will result in substantial prejudice to one or more of the parties. If a panel has not been appointed, the Director shall appoint a single arbitrator to consider the application for a stay. Such single arbitrator shall be selected using the Neutral List Selection System (as defined in Rule 10308) and is not required to have the special employment arbitrator qualifications described in Rule 10211.

(e) Pre-Filing Certification

(1) Prior to or concurrently with filing a Statement of Claim, a claimant may file with the Director a certification that it had communicated unsuccessfully with the respondent concerning the consolidation of all claims in court prior to filing a Statement of Claim, in an effort to save the expense of arbitration fees. A copy of such certification shall be sent to the respondent at the same time and in the same manner as the filing with the Director.

(2) If, after a certification has been filed, all the respondents later exercise the option to consolidate all claims in court, the Director will return the claimant's filing fee and any hearing session deposits for hearings that have not been held, but will retain the member surcharge and any accrued member process fees. If there are any remaining respondents, the filing fee and any hearing deposits will be adjusted to correspond to the claims against the remaining respondents.

(f) Motion to Compel Arbitration

If a member or a current or former associated person of a member files in court a claim against a member or a current or former

associated person of a member that includes matters that are subject to mandatory arbitration, either by the rules of the Association or by private agreement, the defending party may move to compel arbitration of the claims that are subject to mandatory arbitration.

(g) Definitions

For purposes of this Rule:

(1) The term "related claim" shall mean any claim that arises out of the employment or termination of employment of an associated person.

(2) The term "statutory discrimination claim" means a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute.

* * *

INFORMATIONAL

Ombudsman

NASD Office Of The Ombudsman Clarifies Its Role

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Advertising/Investment Companies
- Corporate Finance
- Legal & Compliance
- Registration
- Senior Management
- Trading & Market Making

KEY TOPICS

- Ombudsman

Executive Summary

The National Association of Securities Dealers, Inc. (NASD®) Office of the Ombudsman staff has helped resolve many issues and concerns raised by members and their associated persons, issuers and their associated persons, and investors. With a staff of four full-time Ombudspersons, the Office has been able to better serve the steady growth in the number of concerns that are brought to its attention.

The NASD would like to remind members that the Ombudsman's role does not displace the NASD's existing procedures for handling customer complaints, members' disciplinary grievances, arbitration matters, or issuer concerns. The Ombudsman staff reviews concerns in an objective and confidential manner to resolve matters that fall outside established forums and to ensure that existing structural operations are functioning equitably.

Questions/Further Information

Questions regarding this *Notice* should be directed to the Office of the Ombudsman, at (301) 212-2515, or toll free at (888) 700-0028.

Background

In mid-1996, the NASD created the Office of the Ombudsman (the Office) for the NASD and its subsidiaries, NASD Regulation, Inc. (NASD Regulation℠) and The Nasdaq Stock Market, Inc. (Nasdaq®).

The NASD created the Office in response to recommendations made by the NASD Select Committee on Structure and Governance (see *Notices to Members 95-84*, *95-101*, *95-102*, and *96-35*) that an independent office be established to receive and address "concerns and complaints, whether anonymous or not, from any source (within or outside of the NASD) concerning the operations, enforcement, or other activities of the NASD, NASD Regulation, or Nasdaq, or any staff members."

The Office's purview was expanded to include the American Stock Exchange® (Amex®), including member firms and their employees, upon completion of the NASD/Amex merger.

Description

When an established complaint or appellate process does not exist, Ombudsman staff can serve a dispute resolution function by suggesting actions or policies that are intended to be equitable to all parties. One of the major functions of the Office is to provide confidential assistance to parties inside and outside the NASD regarding a complaint or a concern. The Ombudsman staff will help all parties identify and evaluate options for appropriate actions and remain neutral in doing so. Where an established complaint or appellate process exists, the Ombudsman staff will identify the process, explain it in general terms, and direct the caller to the appropriate office.

In all situations, the Ombudsman's role is to remain neutral. It represents neither the party expressing a concern nor the part of the organization responsible for the process or procedure that causes concern.

Matters That May Be Reviewed

Inconsistent Decisions By NASD Staff

Complaints regarding decisions made or actions taken by NASD staff that may be inconsistent, biased, or result in disparate treatment may be directed to the Office. These complaints may be based on discretionary acts by NASD staff for which an established appellate channel does not exist. The Ombudsman staff will process each complaint received, review or conduct an informal investigation of the allegations, and recommend appropriate action, if warranted.

For issues in which an established complaint or appellate process exists, at its conclusion, concerns about the process may be reviewed and, when necessary, informally investigated.

Weak Procedures

The Office will review complaints of weaknesses in NASD controls, practices, or procedures submitted by persons who, for whatever reason, do not want to, or believe they cannot, report such weaknesses to NASD management or who wish to remain anonymous. This could include, for example, continued failure of an NASD manager to respond to public customers, member firms, or issuers' needs; or the failure of an NASD department to address matters for which it is responsible, or has not carried out a procedure, rule, or regulation correctly.

Matters That Will Not Be Reviewed

Complaints will be directed to the appropriate office in those cases where established procedures currently exist regarding application of rules, policies, procedures, or interpretations. These complaints may deal with various topics and allegations, *e.g.*, Committee or Hearing Panel action, applicability of a rule or a procedure, how an interpretation is applied, etc.

Complaints from member firms and/or their associated persons regarding disciplinary rulings, from issuers regarding listing proceedings, and from member firms regarding application of existing rules by market operations staff, prosecutorial bias, bias by a Hearing Panel, or a conflict of interest by a Hearing Panel member are subject to review by the existing NASD appellate procedures and processes. However, after the appellate process has been exhausted, the Ombudsman will review any systemic issue brought to its attention.

Where a structured dispute resolution and/or appellate process currently exists, that process should continue to be used by parties seeking a redress. Accordingly, in such cases the Ombudsman's role will be limited to informing persons of the existence of the appropriate process for resolution and monitoring the outcome. However, in such cases, Ombudsman staff is authorized to conduct independent reviews of complaints involving particular NASD staff, departments, processes, or procedures.

Arbitration And Mediation

Complaints from parties in arbitration or mediation dealing with arbitrators' rulings, conduct, or awards will not be the focus of the Office. The arbitration staff currently investigates and responds to complaints regarding the arbitration and mediation processes. The Ombudsman staff will only be available for reviewing complaints regarding allegations of NASD staff misconduct, separate from the merits of the arbitration claim. The Ombudsman staff does not have the authority to change an arbitration ruling.

Complaints Regarding Conduct Of Members Or Their Associated Persons

The Office will advise persons who claim to have suffered monetary injury as a result of the conduct of member firms or their associated persons to pursue the matter through arbitration. When a complaint alleges possible violations of rules that the NASD is responsible for enforcing, the Office will also recommend that the complaining party report the matter to the appropriate NASD Regulation District Office for investigation and possible disciplinary action.

Complaints that are within the jurisdiction of another department or organization will be referred by the Office to those areas that have the jurisdiction and expertise to handle them. If the complainant is referred internally to another NASD department, Ombudsman staff will follow up to ensure the appropriate department responds in a timely manner.

Board Rulemaking And Policy Decisions

Because avenues exist for interested persons to express their views on proposed rules under consideration by the NASD Board of Governors or the Directors of NASD Regulation or Nasdaq, the Office does not handle concerns or complaints relating to this area. Persons who wish to participate in the policy formulation process are strongly encouraged to submit comments when proposed rules are published for comment by the NASD and/or the Securities and Exchange Commission.

How To Contact The Office

If members, associated persons, investors, issuers, or others have a complaint or comment regarding an action by the NASD as described in this *Notice*, they can contact the Office of the Ombudsman, at (301) 212-2515, or (888) 700-0028; e-mail: *ombuds@nasd.com*; or write to:

NASD
Office of the Ombudsman
P.O. Box 9492
Gaithersburg, MD 20898-9492

The inquiries may be anonymous and will be treated confidentially.

INFORMATIONAL

Short Sales

NASD Regulation Reiterates That Members Must Comply With All Short Sale Rules When Receiving Orders Through Electronic Order Systems Or The Internet And Reiterates The Operation Of The Affirmative Determination Rule

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Individual Investor
- Internal Audit
- Legal & Compliance
- Operations
- Senior Management
- Technology
- Trading & Market Making

KEY TOPICS

- Affirmative Determination
- Internet Trading
- NASD Conduct Rules 3350 and 3370
- Short Sales

Executive Summary

The purpose of this *Notice* is to reiterate the long-standing position of NASD Regulation, Inc. (NASD Regulation℠) and Nasdaq® that member firms must comply with the rules concerning short sales regardless of how a short sale order is received, *e.g.*, through the telephone, an electronic transmission, the Internet, or otherwise. Accordingly, firms must comply with the bid test, make affirmative determinations, and identify short sales in the Automated Confirmation Transaction Service℠ (ACT℠) for all proprietary and customer short sale orders that are received electronically through proprietary electronic order routing systems, the Internet, or otherwise.

Questions/Further Information

Questions concerning National Association of Securities Dealers, Inc. (NASD®) Rule 3350 (Bid Test Rule) should be directed to the Office of General Counsel, The Nasdaq Stock Market, Inc. (The Nasdaq Stock Market®), at (202) 728-8294; or the Legal Section, Market Regulation, NASD Regulation, at (301) 590-6410. Questions concerning NASD Rule 3370 (Affirmative Determination Rule) should be directed to the Office of General Counsel, NASD Regulation, at (202) 728-8071; or the Legal Section, Market Regulation, NASD Regulation, at (301) 590-6410.

Discussion

Many members receive short sale orders electronically through proprietary electronic order routing systems and through the Internet from customers with online accounts. With this *Notice*, NASD Regulation and Nasdaq reiterate the long-standing position that, absent an exemption, firms must comply with the short sale rules when effecting customer short sale orders, regardless of whether the order is received by telephone or electronically through a proprietary electronic order routing system, the Internet, or otherwise. Failure to do so will result in a violation of the short sale rules and possible disciplinary action.

As a result of the significant increase in online trading, member firms and customers have sought guidance from the NASD concerning the application of the short sale rules to certain specific situations referred to as "double selling," "over selling," and "mistaken sale not long." (Hereinafter collectively referred to as "inadvertent short sales.") Specifically, these situations include, among others:

(1) a customer placing an online sell order to sell a long position in his/her account and, when the order is not immediately executed, entering a second sell order for the same shares resulting in the execution of both orders;

(2) a customer canceling a limit order to sell and replacing it with a market order before confirmation of cancellation of the first order, with both orders eventually being executed because of delays in processing the order cancellation; or

(3) a customer accidentally entering two sell orders for the same shares or entering a sell order for shares when he/she intended to enter buy orders.

All of these scenarios result in the customer causing the member to effect a short sale for the customer even though the customer apparently did not intend to sell short.

Notwithstanding the fact that the customer may not intend to sell short, a member that offers online trading services to its customers must program such systems to ensure that the member is complying with all trading and market-making rules, including the short sale rules. In other words, when the above referenced situations occur, members' systems should consider the stock positions in customer accounts and the number and status of all orders and cancellation instructions. Member firm automated systems should execute such short sales in compliance with the short sale rules, and NASDR℠ and Nasdaq recommend that firms design their systems to provide customers with notice when they may have placed an "inadvertent" short sale. In sum, the means of receipt of a short sale and the "inadvertent" nature of a short sale in no way eliminate or reduce the obligations of member firms to comply with the short sale rules.

Application Of Short Sale Rules To Orders Placed Over The Internet

The Bid Test Rule provides that, absent an exemption, no member shall effect a short sale for the account of a customer or for its own account in a Nasdaq National Market® security at or below the current best (inside) bid when the current best (inside) bid as displayed by The Nasdaq Stock Market is below the preceding best (inside) bid in the security. When a customer short sale order is received electronically or through the Internet, the member must effect such orders in compliance with the Bid Test Rule. Moreover, firms must effect short sales in compliance with the Bid Test Rule regardless of whether the short sale is an "inadvertent" short sale from the customer's perspective.[1]

Similarly, pursuant to NASD Rule 6130(d)(6), a transaction report entered into ACT that reports the execution of such an order must include a symbol that identifies the transaction as a short sale. As stated above, firms must comply with this rule regardless of the manner in which customer short sales are received and whether the short sales are inadvertent from the customer's perspective.

NASD Conduct Rule 3370 regulates both customer and proprietary short sales. As to customer short sales, NASD Conduct Rule 3370(b)(2)(A) states, in relevant part, that "[n]o member or person associated with a member shall accept a 'short' sale order for any customer in any security unless the member or person associated with a member makes an affirmative determination that the member will receive delivery of the security from the customer or that the member can borrow the security on behalf of the customer for delivery by settlement date." Under this provision, the affirmative determination is a prerequisite for accepting a customer's short sale order. Thus, firms must make the required affirmative determination before the customer's short sale order can be accepted and executed. A member firm must conduct the requisite affirmative determination regardless of whether the order is received electronically or through the Internet or whether the order was placed "inadvertently" by the customer.[2]

NASDR also notes that the obligation for making an affirmative determination and complying with the Bid Test Rule rests with member firms and may not be shifted to customers. For instance, members may not satisfy the Affirmative Determination Rule for short sales by merely giving warnings to customers that they are required to make good delivery of the securities or that they will be financially responsible for any losses incurred from covering short sales.

NASD Regulation Reiterates Operation Of The Affirmative Determination Rule

NASD Regulation also reiterates that, absent an exemption, an affirmative determination must be made before executing a proprietary short sale for each and every short sale. A member can **not** implement procedures whereby it only conducts an affirmative determination for proprietary short sales if the firm maintains a short position overnight (that is, if the firm is flat in a certain security by the end of the trading day it will not conduct an affirmative determination). Such a procedure conflicts with the Rule's requirement that a firm make an affirmative determination before executing a proprietary short sale and would circumvent the objectives of the Affirmative Determination Rule that are designed to help prevent situations where there is a shortage of deliverable stock or a failure to deliver. Accordingly, firms are required to ensure that securities are available to cover a proprietary short position before executing the short sale. To make an affirmative determination only if a short position will be maintained overnight would be a direct violation of the Affirmative Determination Rule.[3]

Endnotes

[1]NASDR and Nasdaq also reiterate that firms must effect short rules in exchange-listed securities received electronically, via the Internet, or otherwise in compliance with the Securities Exchange Act Rule 10a-1.

[2]NASD Rule 3370(b)(4) provides that there is no mandated method by which firms must comply with the affirmative determination rule. Accordingly, members may design automated systems that obtain and record the information required by Rule 3370 for short sales. Alternatively, members may direct customers who attempt to place short sale orders electronically or through the Internet to speak with a registered representative by telephone in order to make the affirmative determination.

[3]Likewise, firms may not wait until the end of the day to determine whether an affirmative determination is required for customer short sales. Firms are required to receive assurances that securities are available to cover a customer's potential short position before effecting the customer's short sale order.

INFORMATIONAL

Displaying Customer Limit Orders

NASD Reiterates Obligations To Display Customer Limit Orders Pursuant To SEC Rule 11Ac1-4

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Senior Management
- Systems
- Trading & Market Making

KEY TOPICS

- Limit Orders
- Order Handling Rules
- SEC Rule 11Ac1-4 (Display Rule)

Executive Summary

The National Association of Securities Dealers, Inc. (NASD®), after consultation with the staff of the Securities and Exchange Commission (SEC or Commission), is reiterating the limit order display obligations imposed on members under SEC Rule 11Ac1-4 (Display Rule). One of the primary purposes of this *Notice* is to reiterate that the 30-second requirement to display limit orders does not operate as a safe harbor.

Questions/Further Information

Questions concerning this *Notice* may be directed to Bob Aber, Senior Vice President and General Counsel, The Nasdaq Stock Market, Inc., at (202) 728-8290; or the Market Regulation Department Legal Section, NASD Regulation, Inc. (NASD Regulation℠), at (301) 590-6410.

Discussion

In August 1996, the SEC adopted its Order Handling Rules, which included the Display Rule governing the display of customer limit orders. The Display Rule requires Market Makers to display the full price and size of qualifying limit orders in their quotes, subject to certain enumerated exceptions. Once a customer limit order is obligated to be publicly displayed in accordance with the Display Rule, the Display Rule requires that such a customer limit order be displayed "immediately," unless a specific exception to the rule applies. The SEC has indicated that a Market Maker "must display the order as soon as is practicable after receipt which, under normal market conditions, would require display no later than 30 seconds after receipt".[1]

Firms are afforded a brief opportunity, pursuant to the exceptions contained in the Display Rule[2], to determine whether to display, execute, or route a customer limit order, but under no circumstances can a firm intentionally delay—or rely on an automated system that is programmed to delay—the display of limit orders as a matter of course. As to the specific time parameter in which a Market Maker must act to display, execute, or route a customer limit order, firms should take such action as soon as possible, but no later than 30 seconds after receipt. The 30-second period is an outer limit and under normal market conditions, Market Makers should take such action well before the termination of the 30-second period for most of their customer limit orders.

In determining under what circumstances Market Makers have violated the Display Rule, notwithstanding the fact that a Market Maker has displayed the customer limit orders within 30 seconds after receipt, a number of factors will be evaluated. The following factors should be taken into consideration when evaluating the immediacy with which a customer limit order was displayed:

- the volume of customer limit orders in a particular issue;
- the amount of contemporaneous transactions in the issue by the Market Maker; and
- the volatility of the issue.

To the extent that a firm has determined as a matter of business practice always to display customer limit orders (or otherwise automated the handling of its limit orders such that no human action is

required or involved in the handling of the order), the firm should take action immediately without delay (*i.e.*, within a matter of seconds depending upon the capacity of the firm's system or limit order queues) and any systematic delay in the handling of the orders, regardless of how long, would constitute a violation of the Display Rule. Given the operational differences among firms and the different market attributes of particular securities, however, there is no "bright line, absolute" standard governing the number of seconds a Market Maker has to complete its choice of displaying, executing, or routing a customer limit order. Accordingly, a firm may operate an automated system that defaults to display customer limit orders within 30 seconds of receipt, so long as the firm makes every effort to display the limit orders as soon as possible manually or otherwise.

Endnotes

[1]Order Execution Obligations, 61 Fed. Reg. 48290 (1996) at 48304.

[2]The requirements of the Display Rule do not apply to any customer limit order that:

- is executed upon receipt of the order;
- a customer expressly requests not be displayed;
- is an odd-lot order;
- is a block size order, unless the customer requests that the order be displayed;
- is delivered immediately upon receipt to a qualifying system or ECN;
- is delivered immediately upon receipt to another Market Maker that will display the order or otherwise comply with the rule; or
- is an 'all or none' order.

INFORMATIONAL

Dispute Resolution Subsidiary

SEC Approves Creation Of Dispute Resolution Subsidiary And Related By-Laws And Rule Changes

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Senior Management

KEY TOPICS

- Arbitration
- Dispute Resolution
- Mediation

Executive Summary

The Securities and Exchange Commission (SEC) has approved creation of a subsidiary of the National Association of Securities Dealers, Inc. (NASD®) to handle the dispute resolution program that is currently part of NASD Regulation, Inc. (NASD Regulation℠). The subsidiary is expected to become operational in the spring of 2000.

Questions/Further Information

Questions regarding this *Notice* may be directed to Linda D. Fienberg, Executive Vice President, Office of Dispute Resolution, NASD Regulation, at (202) 728-8407; George H. Friedman, Senior Vice President and Director, Office of Dispute Resolution, NASD Regulation, at (212) 858-4488; or Jean I. Feeney, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-6959.

Discussion

On September 30, 1999, the SEC approved creation of a dispute resolution subsidiary, to be known as NASD Dispute Resolution, Inc. (NASD Dispute Resolution), to take over the dispute resolution functions that are now performed by the Office of Dispute Resolution within NASD Regulation.[1] Specifically, the SEC approved new By-Laws for the subsidiary, and related amendments to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries, the NASD Regulation By-Laws, and the Rules of the Association. A copy of the SEC Approval Order, which contains a description of the amendments, is attached. The changes will not take effect until NASD Dispute Resolution becomes operational.

The NASD believes that creation of the new subsidiary will recognize the importance of its dispute resolution program and further strengthen the independence and credibility of the arbitration and mediation functions. The subsidiary will be subject to the same SEC oversight as the NASD, NASD Regulation, and The Nasdaq-Amex Market Group℠.

NASD Dispute Resolution must now qualify to do business in all jurisdictions in which it will operate. Therefore, it is not expected to begin operation as a separate subsidiary until the spring of 2000. Until that time, the Office of Dispute Resolution will remain part of NASD Regulation.

Endnote

[1]Exchange Act Release No. 41971 (File No. SR-NASD-99-21) (September 30, 1999), 64 *Federal Register* 55793 (October 14, 1999).

compliance consultants, as appropriate, to conduct periodic reviews and evaluations of the compliance policies and procedures, as well as the operation of the compliance program as a whole. The Compliance Manuals will be promptly updated to reflect any necessary changes resulting from these reviews.

c. Compliance Documentation. SI is in the process of adopting procedures to document, on an ongoing basis, the procedures to be followed by Compliance Department personnel in performing particular functions; the actions to be taken by Compliance Department personnel as a result of following the procedures; and the actions to be taken by Legal and Compliance Department personnel and management to enforce the compliance policies and procedures. These policies will require compliance documentation to be prepared in a manner to facilities regulatory review of the factual background of the transactions or matters at issue, as well as the actions taken by SI's personnel.

d. Compliance Training. SI has commenced, and will continue to conduct, training on a firm-wide and departmental basis to ensure that its employees understand the purposes and functions of the compliance policies and procedures.

e. Professional Conduct Program. SI has developed, and is in the process of adopting, a professional conduct code and supporting infrastructure, including the assignment of senior management and Legal Department personnel to design, implement and oversee SI's professional conduct program ("Professional Conduct Program"). Under the Professional Conduct Program, SI will conduct comprehensive yearly professional conduct training. SI is in the process of implementing employee assistance procedures, that will be administered by third-party vendors and senior Legal Department personnel, to answer employee questions and address grievances. Once the Professional Conduct Program is adopted, SI will conduct periodic review and evaluation of the program with a view to enhancing and strengthening it.

Applicant's Conditions

Applicants agree that the following conditions may be imposed in any order granting the requested relief:

1. Mr. Stephens will not be involved in SI's business of providing services to register investment companies. Applicants will develop procedures designed reasonably to assure compliance with this condition.

2. For each to the three fiscal years beginning with the fiscal year ending December 31, 1999, SI's general counsel will certify annually that, after reasonable inquiry, he believes that SI has complied with its compliance procedures and policies in all material respects (and that any known material deviations from these policies and procedures, and any series of like deviations that in the aggregate are material, have been documented in SI's records), and that the procedures and policies continue to be reasonably designed to ensure SI's compliance with the federal securities laws. The certification will be delivered to the Commission to be attention of the Assistant Director, Office of Investment Company Regulation, Division of Investment Management, within 60 days of the end of SI's fiscal year. A copy of the certification will be maintained as part of the permanent records of SI and a copy of each certification will be delivered to the board of directors of each fund for which SI serves as distributor, underwriter, administrator or investment adviser.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99-26792 Filed 10-13-99; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41971; File No. SR-NASD-99-21]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the National Association of Securities Dealers, Inc. To Create a Dispute Resolution Subsidiary

September 30, 1999.

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"), submitted to the Securities and Exchange Commission ("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 create a dispute resolution subsidiary. The proposed rule change was published for comment in the **Federal Register** on June 17, 1999.[3] The Commission received one comment letter on the proposal from the Securities Industry Association ("SIA").[4] This order approves the proposal.

I. Description of the Proposal

The Association is proposing (i) to create a dispute resolution subsidiary, NASD Dispute Resolution, Inc. ("NASD Dispute Resolution"), to handle dispute resolution programs; (ii) to adopt by-laws for the subsidiary; and (iii) to make conforming amendments to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries ("Delegation Plan"), the NASD Regulation By-Laws, and the Rules of the Association.

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").[5] The Rudman Committee reviewed the Association's arbitration and mediation programs from December 1994 through August 1995. The Rudman Report was issued in September 1995.

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 NAD 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.[6]

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

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

[2] 17 CFR 240.19b-4.

[3] *See* Securities Exchange Act Release No. 41510 (June 10, 1999), 64 FR 32575.

[4] Letter from Stephen G. Sneeringer, Chairman of the Arbitration Committee, SIA, to Jonathan G. Katz, Secretary, Commission, dated July 8, 1999 ("SIA Letter").

[5] *Report of the NASD Select Committee on Structure and Governance to the NASD Board of Governors* (September 1995) ("Rudman Report").

[6] *Report of the Arbitration Policy Task force to the Board of Governors National Association of Securities Dealers, Inc.* (January 1996) ("Ruder Report").

one subsidiary to operate Nasdaq, and a new subsidiary, NASD Regulation, Inc., to regulate the broker-dealer members of the NASD.[7] The Ruder Report recommended that the dispute resolution program be housed either in the parent or in NASD Regulation.[8] The Arbitration Department was placed in NASD Regulation in early 1996 based on the recommendation of the Rudman Committee,[9] and the name of the department was changed to the Office of Dispute Resolution ("ODR") shortly thereafter, to reflect the full 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. However, because there are significant differences between the disciplinary role of NASD Regulation and the sponsorship of a neutral forum for the resolution of dispute between members, associated persons, and customers, the NASD believes that creation of a separate dispute resolution entity will further strengthen the independence and credibility of its arbitration and mediation functions. A new dispute resolution subsidiary should 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 Commission and the need to file all by-laws and rule changes with the SEC. 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. Together with NASD Regulation, the two subsidiaries will form the NASD Regulatory and Dispute Resolution Group. Both the NASD directly, and NASD Regulation, indirectly, will be responsible for the actions of NASD Dispute Resolution. Because NASD Dispute Resolution performs its functions through authority delegated by the NASD, the NASD is responsible for proper performance of such functions. Indirectly, NASD Regulation will be responsible for enforcing compliance with decisions rendered by NASD Dispute Resolution concerning NASD members.[10]

Staffing for NASD Dispute Resolution will be the same as ODR, except for the creation of a President position. Certain additional executive positions, if necessary, may be created as well. Many functions of the new subsidiary, 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 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 presently handled for ODR, which is not self supporting. Fees received from parties who use the arbitration and mediation programs are not sufficient to fund the Office's regular actitivies. Rather, as a part of NASD Regulation, ODR shares in the revenue stream of the NASD and its affiliated entities, 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. Apart from accounting changes to reflect the new subsidiary's status, the funding process for the new subsidiary will be the same as that for ODR. 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 are 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 of Governors ("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 boards of the other subsidiaries.

The procedures currently in place for disciplining members and associated persons for noncompliance with arbitration awards will be largely the same. The Code of Arbitration Procedure ("Code"), 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/Association[11] may be deemed conduct inconsistent with just and equitable principles of trade and a violation of NASD Rule 2110. This language presently applies to awards obtained in the NASD Regulation forum, because 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.[12] Thus, the rules of 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.

B. Description of Proposed Amendments

The Association proposes to amend the Delegation Plan 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 delegating authority to NASD Regulation to a new NASD Dispute Resolution section. A

[7] Rudman Report at R-8.

[8] Ruder Report at 151-52.

[9] Rudman Report at R-8.

[10] *See* Section A.1.f. of the Delegation Plan.

[11] The 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* Securities 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.

[12] the 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* Securities Exchange Act Release No. 39326 (Nov. 14, 1997), 62 FR 62385 (Nov. 21, 1997).

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 balanced between industry and non-industry members. It may be desirable, however, to have an odd number of members on 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 Association proposes to amend the NASD Regulation By-Laws to add references to NASD Dispute Resolution in the definitions sections.[13]

Rule 0120(b) will 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 10102(a) of the Code of Arbitration procedure will 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) will 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) will be amended to conform to current practice, in which the NAMC recommend to the Board certain rules and procedures to govern the conduct of arbitration and mediation matters, and does not unilaterally make such changes. The rule currently authorizes the NAMC to establish these rules and procedures. 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 will 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" will 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 will 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 including subsidiaries.

The proposed NASD Dispute Resolution By-Laws are modeled after those of NASD Regulation, with certain 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. 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 committee 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 committee 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, because this power is implied but not specifically stated in the preceding paragraphs of Section 4.13.

II. Comments

The Commission received one comment letter from the SIA,[14] which opposed the proposed rule change. The SIA disagreed with (i) the proposed composition of the NASD Dispute Resolution Board; (ii) the proposed composition of the NAMC; and (iii) the manner in which fees will be imposed by NASD Dispute Resolution.

The SIA had three concerns about the composition of the NASD Dispute Resolution Board. First the SIA stated that industry and non-industry representation should be equal. Second, the SIA noted that it is inappropriate to consider the president of NASD Dispute Resolution as an industry representative. Third, the SIA stated that the proposed compositional breakdown might permit the NASD Dispute Resolution Board to be dominated by claimants' lawyers. The SIA recommended that the Commission exclude from the definition of Non-Industry "anyone who provides professional legal services to investor-claimants and whose revenues in that regard constitute more than 20% of his or her gross annual revenue."[15]

Similarly, the SIA expressed concern about the proposed composition of the NAMC. It stated its position that industry and non-industry representation on the NAMC should be equal rather than at least 50 percent non-industry. The SIA stated that the "amorphous concern that they may be a tie vote * * * does not outweigh the more paramount concern that the representation on the NAMC be truly balanced between Industry and Non-Industry representatives."[16]

In addition to the composition of the NAMC and the NASD Dispute Resolution Board, the SIA commented on the manner in which fees will be imposed under the proposed rule change. The SIA objected to the dichotomy between fees affecting members and those affecting non-members. Under the proposed rule change, the NASD Board must ratify any rule change adopted by the NASD

[13] The NASD also intends to review the NASD and Nasdaq By-Laws and other corporate governance documents to identify other appropriate amendments recognizing the formation of NASD Dispute Resolution.

[14] *See supra*, note 4.

[15] SIA Letter at 4.

[16] SIA Letter at 4–5.

Dispute Resolution Board that imposes fees or other charges on person or entities other than NASD members. Rule changes that impose fees on NASD members do not require NASD Board ratification. The SIA stated that industry participants "should have the opportunity to participate in critical decisions that will impact their business and their bottom line—such as fee increases related to the arbitration system." [17]

NASD Regulation responded to the SIA's concerns about the proposed composition of the NASD Dispute Resolution Board, the proposed composition of the NAMC, and the manner in which fees will be imposed by NASD Dispute Resolution.[18] First, with respect to the composition of the NASD Dispute Resolution Board, NASD Regulation noted that this proposal is consistent with NASD Regulation's bylaws, which require a majority of non-industry members on its Board and its President and Nasdaq's President are also counted as industry participants for compositional and quorum requirements.[19] Second, with respect to the composition of the NAMC, NASD Regulation noted that the NAMC's recommendations are only advisory and that rule changes and major policy changes must be presented to the NASD Dispute Resolution Board for final approval.[20] Third, with respect to NASD Dispute Resolution's authority to impose fees on NASD members without prior review and ratification by the NASD Board, NASD Regulation noted that fee proposals must be submitted for Commission review and that the NASD may, on its own initiative, review any action of its subsidiaries.[21]

III. Discussion

The Commission finds that the proposed rule change is consistent with section 15A(b) of the Act [22] in general and furthers the objectives of section 15A(b)(6) [23] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest.[24] Specifically, the Commission believes that separating the dispute resolution role from the disciplinary role of NASD Regulation will result in a more neutral and independent forum for the resolution of disputes between members, associated persons, and customers. The Commission also expects the NASD to ensure that NASD Dispute Resolution is adequately funded and able to fulfill its responsibilities.

In its comment letter, the SIA stated that industry and non-industry representation on the NASD Dispute Resolution Board and the NAMC should be equal and that the President of NASD Dispute Resolution should not be considered an industry representative. The Commission notes that NASD Dispute Resolution's Board structure is modeled after NASD Regulation's structure. Nasdaq also requires a majority of non-industry directors on its Board. Moreover, the Presidents of both NASD Regulation and Nasdaq are counted as industry participants for board composition and quorum requirements. The Commission believes that it is reasonable to extend this structure to NASD Dispute Resolution.

The SIA also stated that the NASD Dispute Resolution Board may include too many claimants' lawyers, thus permitting domination by a single NASD Dispute Resolution constituency. The Commission disagrees, noting that at least two of the non-industry directors will come from the NASD Board. As characterized by the SIA in its comment letter, the current non-industry members of the NASD Board are senior executives from major corporations with no particular affiliation with the securities industry. Moreover, if NASD Dispute Resolution has a five member Board, only one non-industry director may be chosen from outside the NASD Board. While that director should be knowledgeable in the dispute resolution field, the universe of potential candidates is not limited to claimants' lawyers. Indeed, it is likely that the remaining non-industry position would be filled by a practicing arbitrator, a mediator, or an academic. Accordingly, the Commission does not believe that there is an undue risk that the NASD Dispute Resolution Board will be dominated by an single constituency of the new subsidiary.

The SIA also stated that the NASD Board should be required to ratify rule changes adopted by the NASD Dispute Resolution Board if the rule change imposes fees or other charges on NASD members as well as those affecting non-members. The Commission notes that rule changes by the NASD Regulation and Nasdaq Boards imposing fees or other charges on NASD members do not require ratification by the NASD Board. The Commission also notes that fee proposals must be submitted for Commission review under Rule 19b–4 under the Act. In addition, any member of the NASD Board may call an action of a subsidiary for review at the next NASD Board meeting following the subsidiary's action. The Commission believes these measures provide an adequate safeguard against unreasonable fees being levied against NASD members.

Finally, the Association represents that funding for the new subsidiary will be handled in much the same way as funding for ODR was accomplished. The new subsidiary will share in the revenue stream of the NASD and its affiliated entities, which includes revenue derived from member assessments, various fees and charges, disciplinary fines, and other sources of income. As the new subsidiary is implemented, we expect the NASD to commit to ensuring that NASD Dispute Resolution continues to be properly funded to carry out all its responsibilities.

IV. Conclusion

It Is Therefore Ordered, pursuant to section 19(b)(2) of the Act,[25] that the proposed rule change (SR–NASD–99–21) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[26]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–26793 Filed 10–13–99; 8:45 am]

BILLING CODE 8010–01–M

[17] SIA Letter at 5.

[18] Letter from Jean I. Feeney, Assistant General Counsel, NASD Regulation, to Richard C. Strasser, Assistant Director, Commission, dated August 11, 1999.

[19] *Id.* at 2.

[20] *Id.* at 4.

[21] *Id.*

[22] 15 U.S.C. 78*o*–3(b).

[23] 15 U.S.C. 78*o*–3(b)(6).

[24] In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[25] 15 U.S.C. 78s(b)(2).

[26] 17 CFR 200.30–3(a)(12).

SMALL BUSINESS ADMINISTRATION

[Declaration of Disaster #3220]

State of Florida; Amendment #1

The above-numbered declaration is hereby amended to include Marion County, Florida as a contiguous county as a result of damages caused by Hurricane Floyd that occurred September 13–15, 1999.

All other information remains the same, i.e., the deadline for filing applications for physical damage is November 26, 1999 and for economic injury the deadline is June 27, 2000.

(Catalog of Federal Domestic Assistance Program Nos. 59002 and 59008)

INFORMATIONAL

Web-Based Regulatory Applications

NASD Regulation To Launch Additional Form Filing Regulatory Applications

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Executive Representatives
- Legal & Compliance
- Operations
- Senior Management
- Systems

KEY TOPICS

- Forms/Electronic Filing

Executive Summary

NASD Regulation, Inc. (NASD Regulation℠) will deploy the following four additional Web-Based Form Filing Regulatory Applications to National Association of Securities Dealers, Inc. (NASD®) members during the first quarter of 2000.

- Bluesheets (NASD Procedural Rules 8210, 8211, and 8213);
- Customer Complaints (NASD Conduct Rule 3070);
- Reg T/15c3-3 Extension Requests; and
- Shorts Interest Reporting (NASD Conduct Rule 3360).

These regulatory applications will allow firms to use the same entitlement user account and password used to access Web-Based FOCUS—the first of the form filing applications launched a few months ago. Like Web-Based FOCUS, firms will no longer need to load software or file via Sprint Telenet or the Securities Industry Automation Corporation (SIAC), but instead can access all of the form filing applications with one Internet address: *https://regulationformfiling.nasdr.com.*

Firms must use these new Web-Based applications beginning first quarter of 2000. The old filing methods will no longer be available.

Questions/Further Information

For further information or if you have questions about the new Web-Based form filing applications, call (800) 321-NASD, or send an e-mail to: *nasdregformfiling@nasd.com.*

Questions And Answers About The New Web-Based Applications

Who would be required to file using these form filing applications?

If your firm is designated to NASD Regulation for regulatory oversight, then your firm is required to file Customer Complaints, RegT/15c3-3 Extension Requests, and Shorts Interest Reporting to the NASD utilizing these applications. The Bluesheets application can be used by all NASD members that receive Bluesheet requests from the NASD pursuant to NASD Procedural Rules 8210, 8211, and 8213.

How do I prepare for the new form filing regulatory applications?

Your firm must be entitled to use any of the new form filing regulatory applications. Contact your firm's Web-Based FOCUS Account Administrator to request the additional entitlements. The Account Administrator—that would have been identified through the Web-Based FOCUS entitlement process—can request additional user entitlements online via the Entitlement Administration Tool of the Web-Based FOCUS application.

What if I am a Web-Based FOCUS Account Administrator and will also be the Account Administrator for the other new form filing regulatory applications?

The firm must submit a Regulation Applications Administrator Entitlement Form for *each Account Administrator* that is requesting additional entitlement privileges.

What if my firm would like to have a separate Account Administrator for each form filing application?

The member firm has the option to appoint separate Account Administrators for each application. It is recommended that each Account Administrator have a backup or alternate. For new Account Administrators, firms must submit a Regulation Applications User Accounts Acknowledgment Form (UAAF) and Regulation Applications Administrator Entitlement Form. Firms should have received copies of these forms from NASD Regulation during the Web-Based FOCUS entitlement process. If you need another copy of these forms, call (800) 321-NASD, or send an e-mail to *nasdregformfiling@nasd.com.*

Are the system requirements for these new applications different than for Web-Based FOCUS ?

The system requirements for form filing regulatory applications are the same as Web-Based FOCUS.

See below for system requirements.

System Requirements

Minimum Client Required		Recommended Client	
Hardware:	Pentium x90MHz 16MB	***Hardware:***	Pentium x133MHz 32MB
Operating System:	Windows 95 Windows NT 4.0	***Operating System:***	Windows 95 / 98 Windows NT 4.0
Modem:	28.8KB	***Modem:***	56KB
Web Browser:	Internet Explorer 4.01 SP2 Netscape 4.05	***Web Browser:***	Internet Explorer 4.01 SP2 Netscape 4.05
Web Browser Specifics:	Javascript enabled (this is usually the default setting)*	***Web Browser Specifics:***	Javascript enabled (this is usually the default setting)*
Screen Resolution:	800 x 600	***Screen Resolution:***	1024 x 768

* The system will not function without Javascript enabled.

INFORMATIONAL

Reg T And SEC Rule 15c3-3 Reason Codes

NASD Announces Changes To Regulation T And SEC Rule 15c3-3 Extension Request Reason Codes; **Effective Date: February 7, 2000**

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Operations
- Senior Management

KEY TOPICS

- Regulation T
- SEC Rule 15c3-3

Executive Summary

The National Association of Securities Dealers, Inc. (NASD®) is making several changes to its Extension Request Reason Codes regarding Federal Reserve Board Regulation T and Securities and Exchange Commission (SEC) Rule 15c3-3. The changes include adding codes and aligning some NASD codes with New York Stock Exchange (NYSE) codes; the changes will take effect on February 7, 2000.

The charts in Attachment A outline the reason codes and the changes.

Questions/Further Information

Questions regarding this *Notice to Members* may be directed to Susan DeMando, Regional Compliance Supervisor, Member Regulation, NASD Regulation, Inc. (NASD Regulation℠) at (202) 728-8411.

Background

The Federal Reserve Board's Regulation T and SEC Rule 15c3-3 provide for the possibility of extensions where investors have not promptly met their obligations relative to a securities transaction.

Regulation T pertains to an investor's obligation when a security is purchased. Specifically, an investor is given a maximum of five business days to pay for securities purchased in a cash or margin account. If payment due exceeds $1,000 and is not received by the end of this time period, the broker/dealer must either liquidate the position or apply for and receive an extension from its designated examining authority.

SEC Rule 15c3-3 pertains to a customer's obligation when securities are sold, other than short sales. SEC Rule 15c3-3 requires that if a security sold long has not been delivered within 10 business days after the settlement date, the broker/dealer must either buy the customer in or apply for and receive an extension from its designated examining authority.

Clearing firms are reminded of their obligations under the Net Capital Rule relative to Regulation T and outstanding deposits and/or margin as described in SEC Rule 15c3-1 (c)(2)(iv)(B). In addition, should a customer fail to meet his/her responsibilities to deliver a security and that failure results in a clearing firm fail-to-deliver, the Net Capital Rule requires charges under certain conditions. These charges are outlined in SEC Rule 15c3-1 (c)(2)(ix).

Key Features

Following are key features of the current reason codes and some changes:

- Under Regulation T, we are adding reason code 001 ("contacting customer"). This reason code is available one time only for a given trade date and is available for a maximum of seven calendar days. If a customer needs an additional extension related to that trade date, the firm will have to select a new reason code. The reason code can be used starting February 7, 2000.

- Regulation T reason code 021 ("other") may only be assigned by NASD staff. A member firm may not input "other" as a valid reason code. A firm needing a Regulation T extension for reasons other than those provided for in reason codes 001-009, 012, 014, 015[1], 017-020 will need to request and

receive NASD approval and input of the code "other". To facilitate such a request, a firm must contact their District Office. *The use of reason code 021 will be allowed only in extreme and unavoidable circumstances.*

- Rule 15c3-3 reason code 050 ("other") may only be assigned by NASD staff. A member firm may not input "other" as a valid reason code. A firm needing a Rule 15c3-3 extension for reasons other than those provided for in reason codes 040-045, 047-049 and 052[2] will need to request and receive NASD approval and input of the code "other". To facilitate such a request, a firm must contact their District Office. *The use of reason code 050 will be allowed only in extreme and unavoidable circumstances.*

- For Regulation T extensions, a customer will still be limited to a maximum of five request dates per rolling 12-month period for certain reason codes. For Rule 15c3-3 extensions, a customer will be permitted nine (increased from the current five) request dates per rolling 12-month period.

Endnotes

[1]Regulation T reason code 016 ("Acts of God") may also only be used by NASD. However, it is not a reason code that can be applied on an individual customer basis. Acts of God are limited to regional difficulties like earthquake, flood, etc.; when granted, this reason code applies to affected customers in a geographic area, not to individual customers.

[2]SEC Rule 15c3-3 reason codes 046 ("Strike or Christmas") and 051 ("Acts of God") are only assigned by NASD and can not be requested on behalf of an individual customer.

Attachment A

Regulation T Extension Request Reason Codes

Reason Code	Reason Text	Days Permitted	Limit of 5 per Customer	Limit per Reason Code	Final Reason Code	NASD Only	Business Or Calendar Days
001	Contacting Customer	7	Y	1	N	N	C
002	Check Is In The Mail	7	Y	1	Y	N	C
003	Authorization To Transfer Funds	7	Y	1	Y	N	C
004	Awaiting Collateral	7	Y	1	Y	N	C
005	Rcpt Of Sec Sold Offset Purchase	7	Y	1	Y	N	C
006	Legal Documents	7	Y	2	Y	N	C
007	Unacceptable Check	7	Y	1	Y	N	C
008	Foreign Sec. Settle.	7	Y	1	Y	N	B
009	Customer III	7	Y	2	Y	N	C
012	COD-DK-Outside U.S.	7	N	1	Y	N	C
014	COD-DK-In U.S.	2	N	1	Y	N	B
015	COD-Fail-35 Days	14	N	2	Y	N	C
016	Acts Of God	14	N	0	N	Y	C
017	Coming From Another Broker	14	N	2	Y	N	C
018	Death In Family	14	Y	1	Y	N	C
019	Awaiting Appt Of Executor	14	Y	2	Y	N	C
020	Transfer cash to another a/c	0	N	1	N	N	C
021	Other	14	N	1	N	Y	C

SEC Rule 15c3-3 Extension Request Reason Codes

Reason Code	Reason Text	Days Permitted	Limit of 9 per Customer	Limit per Reason Code	Final Reason Code	NASD Only	Business Or Calendar Days
040	Security In Transit	14	N	2	Y	N	C
041	Death Of Seller	14	Y	2	Y	N	C
042	Can't Buy In, Sec Short Supply	14	N	5	Y	N	C
043	Dividend Sold Before Payable Date	14	Y	2	Y	N	C
044	Still In Foreign Deposit	14	Y	2	Y	N	C
045	Sec Exchange Or Merger	14	Y	2	Y	N	C
046	Strike or Xmas	14	N	0	N	Y	C
047	Coming From Another Broker	14	N	2	Y	N	C
048	Customer Ill Or Hospitalized	14	Y	2	Y	N	C
049	Lost Certificate	30	N	5	N	N	C
050	Other	14	N	0	N	Y	C
051	Acts Of God	14	N	0	N	Y	C
052	Foreign Settlements	10	N	2	Y	N	C

These Regulation T and SEC Rule 15c3-3 reason codes have been changed.

NASD Code	Old Description	New Description
	Reg-T Codes	**Reg-T Codes**
021	Confirm sent to wrong address	Other
	15c3-3 Codes	**15c3-3 Codes**
050	Lost Certificate: Customer (Combined into 049 Lost Certificate)	Other
052	Other	Foreign Settlements

These Regulation T and SEC Rule 15c3-3 reason codes have been added.

NASD Code	Description
	Reg-T Codes
008	Foreign Security Settlement
020	Transfer Cash to Another Account
	15c3-3 Codes
046	Strike or Christmas

These Regulation T reason codes have been deleted.

NASD Code	Description
022	Corrected Confirm Requested
023	Duplicate Confirm Requested
024	Cust Out Of Town-No Return Dt
025	Cust Out Of Town-Return Dt
026	Bank In Receivership
027	Cust Away On Business-Ret Dt
028	Confirm Sent To Wrong Address

INFORMATIONAL

Investment Companies And Variable Contracts

SEC Approves Rule Change Relating To Sales Charges For Investment Companies And Variable Contracts; **Effective Date: April 1, 2000**

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Mutual Fund
- Registered Representatives
- Senior Management
- Training
- Variable Contracts

KEY TOPICS

- Investment Companies
- Mutual Funds
- NASD Rules 2820 And 2830
- Variable Contracts

Executive Summary

On October 20, 1999, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD®) Rules 2820 (Variable Contracts Rule) and 2830 (Investment Company Rule) that regulate the sales charges imposed by investment companies and variable annuity contracts sold by NASD members. Generally, the amendments revise the Investment Company Rule to:

- provide maximum aggregate sales charge limits for fund-of-funds arrangements;
- permit mutual funds to charge installment loads;
- prohibit loads on reinvested dividends;
- impose redemption order requirements for shares subject to contingent deferred sales loads (CDSLs); and
- eliminate duplicative prospectus disclosure.

The amendments revise the Variable Contracts Rule to eliminate the specific sales charge limitations in the rule and a filing requirement relating to changes in sales charges. The amendments are effective on April 1, 2000. The text of the amendments is included in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Thomas M. Selman, Vice President, Investment Companies/Corporate Financing, NASD Regulation, Inc. (NASD Regulation℠) at (202) 728-8068; or Joseph P. Savage, Counsel, Advertising/Investment Companies Regulation, NASD Regulation, at (202) 728-8233.

Amendments To The Investment Company Rule

Funds Of Funds

The National Securities Markets Improvement Act of 1996 (NSMIA) amended the Investment Company Act of 1940 (1940 Act) to, among other things, expand the ability of mutual fund sponsors to create "fund of funds"[1] structures. At the time NSMIA was enacted, the Investment Company Rule did not specifically address two-tier fund of fund structures in which both the acquiring fund and the underlying fund impose sales charges. We have amended the Investment Company Rule to ensure that, if both levels of funds in a fund of funds structure impose sales charges, the combined sales charges do not exceed the maximum percentage limits currently contained in the rule.

The amendments permit the acquiring fund, the underlying fund, or both, to impose asset-based sales charges that in the aggregate do not exceed 0.75 percent of average net assets, and service fees that in the aggregate do not exceed 0.25 percent. Aggregate front-end and deferred sales charges in any transaction are limited to 7.25 percent of the amount invested, or 6.25 percent if either the acquiring fund or the underlying fund pays a service fee.

The amendments impose the rule's restrictions on the use of the terms "no load" or "no sales charge" on the acquiring fund, the underlying fund, and those funds in combination. The amendments require funds in a fund of funds structure that impose asset-based sales charges to make their remaining amount calculations on

an individual basis. The amendments do not, however, require funds of funds to make this calculation on an aggregate basis.

Deferred Sales Loads

In 1996, the SEC amended Rule 6c-10 under the 1940 Act to allow certain types of deferred sales charges, such as back-end and installment loads. The amendments conform the definition of "deferred sales charge" in the Investment Company Rule to the definition of "deferred sales load" in Rule 6c-10.[2] Thus, "deferred sales charge" is now defined as "any amount properly chargeable to sales or promotional expenses that is paid by a shareholder after purchase but before or upon redemption." This amendment makes clear that members may offer funds that impose deferred sales charges permitted under Rule 6c-10, subject to the sales charge limits imposed by the Investment Company Rule.

Loads On Reinvested Dividends

The amendments to the Investment Company Rule generally prohibit members from offering or selling the shares of an investment company if it has a front-end or deferred sales charge imposed on shares purchased through the reinvestment of dividends. The prohibition of sales loads on reinvested dividends will not apply to any investment company whose registration statement under the Securities Act of 1933 (1933 Act) was or will be declared effective prior to April 1, 2000. This exception effectively "grandfathers" all existing mutual funds and unit investment trusts (UITs), as well as those mutual funds and UITs whose 1933 Act registration statements become effective prior to April 1, 2000.[3] New mutual funds and UITs that are declared effective under the 1933 Act (including new funds or UITs created pursuant to a post-effective amendment to an existing registration statement under the Investment Company Act of 1940) on or after April 1, 2000, are subject to the prohibition.

CDSL Calculations

The amendments to the Investment Company Rule reinstate redemption order requirements for shares subject to CDSLs that were eliminated by the SEC's 1996 amendments to its Rule 6c-10. As amended, the Investment Company Rule prohibits members from offering or selling the shares of an investment company subject to a CDSL unless the CDSL is calculated so that shares not subject to the CDSL are redeemed first, and other shares are then redeemed in the order purchased. This first-in-first-out (FIFO) redemption order requirement generally ensures that shareholder transactions are subject to the lowest applicable CDSL. The amendments do allow a redemption order other than FIFO, however, if it would result in the redeeming shareholder paying a lower CDSL.

Prospectus Disclosure

Prior to these amendments, the Investment Company Rule prohibited a member from offering or selling shares of an investment company with an asset-based sales charge unless its prospectus disclosed that long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charges permitted in the rule. In March 1998, the SEC adopted significant revisions to mutual fund prospectus disclosure requirements, one of which was a disclosure requirement related to asset-based sales charges. In light of this SEC requirement, NASD Regulation is eliminating this disclosure requirement in the Investment Company Rule.

Amendments To The Variable Contracts Rule

In 1996, NSMIA fundamentally changed the way the SEC regulates sales charges for variable insurance contracts by eliminating specific limits on fees and imposing a reasonableness standard on aggregate fees. This reasonableness standard is to be administered by the SEC.

In light of these amendments, NASD Regulation is eliminating the maximum sales charge limitations in the Variable Contracts Rule. The amendments also make a conforming change to eliminate the requirement to file the details of any changes in a variable annuity's sales charges with the Advertising/Investment Companies Regulation Department.

Effective Date Of Amendments

The amendments to the Variable Contracts Rule and Investment Company Rule are effective on April 1, 2000.

Endnotes

[1]"Fund of funds" is defined as an investment company whose investments in other registered investment companies exceed the limits permitted under Section 12(d)(1)(A) of the 1940 Act. Section 12(d)(1)(A) of the 1940 Act permits an investment company to invest in up to three percent of the outstanding voting shares of another investment company, provided that the value of such shares represents less than five percent of the acquiring fund's total assets, and the acquiring fund's investments in all other funds represent less than 10 percent of the acquiring fund's total assets.

[2]*See* 17 C.F.R. § 270.6c-10(b)(3).

[3]To the extent that footnote 7 of the SEC's order approving the amendments suggests that they do not "grandfather" existing investment companies, that inference is incorrect.