



<b>Regulatory Information Circular</b>			
<b>Circular number:</b>	2007-17	<b>Contact:</b>	Michael J. Simon
<b>Date:</b>	July 19, 2007	<b>Telephone:</b>	212-897-0230

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## **Subject: Rule Change Notice – Changes to NASD Arbitration Rules**

Pursuant to ISE Rule 1800, which in part states that the NASD's Code of Arbitration shall govern ISE arbitrations, this Regulatory Information Circular informs Members of proposed rule changes to the NASD Code of Arbitration published by the Securities and Exchange Commission, attached.

In the July 17, 2007 *Federal Register*, the Commission published notice of filing of a proposed rule change (SR-NASD-2007-021) by NASD to amend the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes to amend the definition of public arbitrator to add an annual revenue limitation.

(Securities Exchange Act Release No. 34-56039 (July 10, 2007))

amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of Nasdaq. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-NASDAQ-2007-024 and should be submitted on or before August 7, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

J. Lynn Taylor,

Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56039; File No. SR-NASD-2007-021]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc., Notice of Filing of Proposed Rule Change To Amend the Definition of Public Arbitrator

July 10, 2007.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 12, 2007, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. ("NASD Dispute Resolution") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit

comments on the proposed rule change from interested persons.

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

NASD Dispute Resolution proposes to amend the Code of Arbitration Procedure for Customer Disputes ("Customer Code"), and the Code of Arbitration Procedure for Industry Disputes ("Industry Code") to amend the definition of public arbitrator to add an annual revenue limitation. The text of the proposed rule change is available at NASD, <http://www.nasd.com>, and the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

NASD has taken numerous steps in recent years to ensure the integrity and neutrality of its arbitrator roster by addressing classification of arbitrators. For example, in August 2003, NASD proposed changes to Rules 10308 and 10312 of the Code of Arbitration Procedure ("Code") to modify the definitions of public and non-public arbitrators to further prevent individuals with significant ties to the securities industry from serving as public arbitrators.<sup>3</sup> The 2003 proposal:

<sup>3</sup> In July 2002, the SEC retained Professor Michael Perino to assess the adequacy of arbitrator disclosure requirements at NASD and at the New York Stock Exchange (NYSE). Professor Perino's report (Perino Report) concluded that undisclosed conflicts of interest were not a significant problem in arbitrations sponsored by self-regulatory organizations (SROs), such as NASD and the NYSE. However, the Perino Report recommended several amendments to SRO arbitrator classification and disclosure rules that might "provide additional assurance to investors that arbitrations are in fact neutral and fair." This proposal implemented the recommendations of the Perino Report and made several other related changes to the definitions of public and non-public arbitrators that were consistent with the Perino Report recommendations. The Perino Report is available at <http://www.sec.gov/pdf/arbconflict.pdf>.

- Increased from three years to five years the period for transitioning from a non-public to public arbitrator after leaving the securities industry.

- Clarified that the term "retired" from the industry includes anyone who spent a substantial part of his or her career in the industry.

- Prohibited anyone who has been associated with the industry for at least 20 years from ever becoming a public arbitrator, regardless of how long ago the association ended.

- Excluded from the public arbitrator roster attorneys, accountants, or other professionals whose firms have derived 10 percent or more of their annual revenue in the previous two years from clients involved in securities-related activities.

The proposal was approved by the SEC on April 16, 2004, and became effective on July 19, 2004.<sup>4</sup>

On July 22, 2005, NASD proposed a further amendment to Rule 10308 of the Code relating to arbitrator classification to prevent individuals with certain indirect ties to the securities industry from serving as public arbitrators. Specifically, NASD proposed to amend the definition of public arbitrator to exclude individuals who work for, or are officers or directors of, an entity that controls, is controlled by, or is under common control with, a broker/dealer, or who have a spouse or immediate family member who works for, or is an officer or director of, an entity that is in such a control relationship with a broker/dealer. NASD also proposed to amend Rule 10308 to clarify that individuals registered through broker-dealers may not be public arbitrators, even if they are employed by a non-broker-dealer (such as a bank). This rule filing was approved by the SEC on October 16, 2006, and became effective on January 15, 2007.<sup>5</sup>

Finally, during the time that the above changes were being made, NASD also had pending at the Commission a 2003 proposal to amend the Code to reorganize the rules into the Customer Code, the Industry Code, and a separate code for mediation. The final provisions of this proposal were approved by the Commission on January 24, 2007, and became effective on April 16, 2007.<sup>6</sup>

<sup>4</sup> See Securities Exchange Act Rel. No. 49573 (April 16, 2004), 69 FR 21871 (April 22, 2004) (SR-NASD-2003-95) (approval order). The changes were announced in Notice to Members 04-49 (June 2004).

<sup>5</sup> See Securities Exchange Act Rel. No. 54607 (Oct. 16, 2006), 71 FR 62026 (Oct. 20, 2006) (SR-NASD-2005-094) (approval order). The changes were announced in Notice to Members 06-64 (November 2006).

<sup>6</sup> See Securities Exchange Act Rel. No. 51856 (June 15, 2005), 70 FR 36442 (June 23, 2005) (SR-

<sup>6</sup> 17 CFR 200.30-3(a)(12).

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

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

Several of the substantive changes to the Customer and Industry Codes will affect the classification of arbitrators<sup>7</sup> and how they are selected for panels.<sup>8</sup>

Despite these many initiatives amending the arbitrator classification rules, some users of the forum continue to voice concerns about individuals serving as public arbitrators when they have business relationships with entities that derive income from broker-dealers. The concern is that, for example, an arbitrator classified as public might work for a very large law firm that derived less than 10% of its annual revenue from broker-dealer clients, but still receives a large dollar amount of such revenue. The concern focused primarily on the law firm's defense of action (in arbitration or litigation) by customers of broker-dealers, and not on representing broker-dealers in underwriting or other activities. Therefore, those concerned with the amount of annual revenue recommended that there be an annual dollar limitation of \$50,000 on revenue from broker-dealers relating to customer disputes with a brokerage firm or associated person concerning an investment account.

NASD supports these recommendations and is, therefore, proposing to amend the definition of public arbitrator in Rule 12100(u) of the Customer Code and Rule 13100(u) of the Industry Code to add a provision that would prevent an attorney, accountant, or other professional from being classified as a public arbitrator, if the person's firm derived \$50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in Rule 12100(p)(1) of the Customer Code or Rule 13100(p)(1) of the Industry Code relating to any customer disputes concerning an investment account or transaction, including but not limited

to, law firm fees, accounting firm fees, and consulting fees.<sup>9</sup>

NASD believes the proposed amendment, in conjunction with the existing 10 percent revenue limitation,<sup>10</sup> will further improve NASD's public arbitrator roster by ensuring that arbitrators whose firms receive a significant amount of compensation from any persons or entities associated with or engaged in the securities, commodities, or futures business are removed from the public roster.<sup>11</sup>

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change will enhance investor confidence in the fairness and neutrality of NASD's arbitration forum, by providing further assurance to parties that persons who have a relationship with those who receive a significant amount of compensation from the securities industry are not able to serve as public arbitrators in NASD arbitrations.

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

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

<sup>9</sup> Rule 12100(p) defines "non-public arbitrator." Paragraph (1) of the rule states, in relevant part, that the term "non-public arbitrator" means a person who is otherwise qualified to serve as an arbitrator and is or, within the past five years, was: (A) Associated with, including registered through, a broker or a dealer (including a government securities broker or dealer or a municipal securities dealer); (B) registered under the Commodity Exchange Act; (C) a member of a commodities exchange or a registered futures association; or (D) associated with a person or firm registered under the Commodity Exchange Act. Rule 13100(p) is the same as Rule 12100(p).

<sup>10</sup> See supra note 4. Under the July 2004 amendments, a public arbitrator cannot be "an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past 2 years from any persons or entities listed in Rules 12100(p)(1) and 13100(p)(1) of the new Codes."

<sup>11</sup> NASD will survey its public arbitrators to determine which arbitrators will be removed from the roster for appointment to new cases upon the effective date of the proposed rule.

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

Written comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the *Federal Register* or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2007-021 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2007-021. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than

NASD-2003-158) (notice); See Securities Exchange Act Rel. No. 51857 (June 15, 2005), 70 FR 36430 (June 23, 2005) (SR-NASD-2004-011) (notice); and See Securities Exchange Act Rel. No. 51855 (June 15, 2005), 70 FR 36440 (June 23, 2005) (SR-NASD-2004-013) (notice). The changes were announced in Notice to Members 07-07 (February 2007).

<sup>7</sup> NASD believes the new Codes have improved the arbitrator selection process by creating and maintaining a new roster of arbitrators who are qualified to serve as chairpersons. The chair roster will consist of more experienced arbitrators available on NASD's public arbitrator roster for all investor cases and for certain intra-industry cases. For other industry cases, the Code also creates a chair roster of experienced non-public arbitrators. See Rules 12400(b) and (c) of the Customer Code and Rules 13400(b) and (c) of Industry Code.

<sup>8</sup> The new Codes also change how arbitrator lists are generated and how arbitrators are selected for a panel. See Rules 12403 and 12404 of the Customer Code and Rules 13403 and 13404 of the Industry Code.

those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2007-021 and should be submitted on or before August 7, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Florence E. Harmon,  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56040; File No. SR-NYSEArca-2007-67]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Extend the Quarterly Options Series Pilot Program for a Two-Week Period

July 10, 2007.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 10, 2007, NYSE Arca, Inc. ("Exchange" or "NYSE Arca") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been substantially prepared by the Exchange. The Exchange has designated this proposal as non-controversial under section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposed rule change effective upon filing with the Commission. The Commission is publishing this notice to solicit

comments on the proposed rule change from interested persons.

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

The Exchange is proposing to extend the Quarterly Options Series pilot program ("Pilot Program") for an additional two-week period, through July 24, 2007, and to amend Rule 5.19(a) regarding the restriction on the number of strike prices for Quarterly Options Series based on an underlying index. The text of the proposed rule change is available on the Exchange's Web site (<http://www.nysearca.com>), at the Exchange's principal office, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

On July 12, 2006, the Exchange filed with the Commission a proposed rule change that allowed it to establish the Pilot Program, pursuant to which the Exchange lists and trades Quarterly Options Series.<sup>5</sup> The rule change was effective upon filing. The Exchange hereby proposes to extend the Pilot Program for an additional two-week period, so that it will expire on July 24, 2007.<sup>6</sup>

In the Pilot Program Release, the Exchange stated that it would submit, in connection with any proposed extension of the Pilot Program, a Pilot Program Report ("Report") that would provide an analysis of the Pilot Program

covering the entire period which the program was in effect. The Report will include: (1) Data and written analysis on the open interest and trading volume in the classes for which Quarterly Options Series were opened; (2) an assessment of the appropriateness of the option classes selected for the Pilot Program; (3) an assessment of the impact of the Pilot Program on the capacity on the Exchange, OPRA, and market data vendors (to the extent data from market data vendors is available); (4) any capacity problems or other problems that arose during the operation of the Pilot Program and how the Exchange addressed such problems; (5) any complaints that the Exchange received during the operation of the Pilot Program and how the Exchange addressed them; and (6) any additional information that would assist the Commission in assessing the operation of the Pilot Program. The Exchange plans to submit the Report in connection with a proposal that will extend the Pilot Program until July 10, 2008. This proposal and Report will be filed with the Commission at the conclusion of the proposed two-week extension.

The Exchange also proposes at this time to add a provision to Rule 5.19(a) regarding the limitations on the number of strikes the Exchange may list for Quarterly Options Series based on an underlying index. These changes mirror provisions previously submitted by the Chicago Board Options Exchange ("CBOE") and approved by the Commission.<sup>7</sup> The Exchange proposes to: (1) Limit the number of strike prices that the Exchange may initially open for Quarterly Options Series to five strike prices above and five below the value of the underlying index; (2) clarify that the Exchange may open for trading additional Quarterly Options Series of the same class when the Exchange deems such action necessary to maintain an orderly market or meet customer demand, provided that the additional series priced above (below) the value of the underlying index do not cause there to be more than five strike prices above (below) the value of the underlying index; and (3) clarify that the opening of any new Quarterly Options Series will not affect the previously opened series of the same class. These changes are based on CBOE Rule 24.9 and are shown in Exhibit 5 to the proposed rule change on Form 19b-4 filed with the Commission.

<sup>5</sup> See Securities Exchange Act Release No. 54166 (July 18, 2006), 71 FR 42151 (July 25, 2006) (File No. SR-NYSEArca-2006-45) ("Pilot Program Release").

<sup>6</sup> At the end of this proposed two-week extension, NYSE Arca will submit a subsequent proposal to the Commission, in conjunction with a report on the Pilot Program, requesting that the Pilot Program be extended until July 10, 2008.

<sup>7</sup> See Securities Exchange Act Release No. 54762 (November 16, 2006), 71 FR 67663 (November 22, 2006) (File No. SR-CBOE-2006-93).

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

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).