For further information, please contact Lourdes Gonzalez at (202) 942–0098, Linda Stamp Sundberg at (202) 942–0073, Bonnie Gauch at (202) 942–0765, Rose Wells at (202) 942–0143, or Matt Comstock at (202) 942–0156.

The subject matter of the Closed Meeting scheduled for Thursday, April 29, 2004 will be:

Formal orders of investigation;

Institution and settlement of injunctive actions;

Institution and settlement of administrative proceedings of an enforcement nature;

Consideration of amicus participation; an adjudicatory matter; and an Opinion.

At times, changes in Commission priorities require alterations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact: The Office of the Secretary at (202) 942–7070.

Dated: April 20, 2004.

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 04–9344 Filed 4–20–04; 3:59 pm]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49573; File No. SR–NASD–2003–95]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to a Proposed Rule Change Relating to Arbitrator Classification and Disclosure in NASD Arbitrations

April 16, 2004.

I. Introduction

On June 12, 2003, the National Association of Securities Dealers, Inc. (“NASD’’ or “Association’’), filed with 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 amend certain sections of the NASD Code of Arbitration Procedure (“Code’’) relating to arbitrator classification and disclosure in NASD arbitrations. The proposed rule change was published for comment in the **Federal Register** on August 21, 2003.[3] The Commission received eight comment letters on the proposal.[4] NASD submitted two letters in response to these comments.[5] This order approves the proposed rule change.

II. Description of the Proposed Rule Change

Under the proposal, Rules 10308 and 10312 of the Code would be amended to: (1) Modify the definitions of public and non-public arbitrators; (2) provide specific standards for deciding challenges to arbitrators for cause; and (3) clarify that compliance with arbitrator disclosure requirements is mandatory.

Specifically, the proposed rule change would amend the definition of non-public arbitrator in Rule 10308(a)(4) of the Code to: (1) Increase from three years to five years the period for transitioning from an industry to public arbitrator; and (2) clarify that the term “retired’’ from the industry includes anyone who spent a substantial part of his or her career in the industry.

In addition, the proposed rule change would amend the definition of public arbitrator in Rule 10308(a)(5)(A) of the Code to: (1) Prohibit anyone who has been associated with the industry for at least 20 years from ever becoming a public arbitrator, regardless of how many years ago the association ended; (2) exclude from the definition of public arbitrator, attorneys, accountants, and other professionals whose firms have derived 10 percent or more of their annual revenue, in the last two years, from clients involved in the activities defined in the definition of non-public arbitrator; and (3) provide that investment advisers may not serve as public arbitrators and may only serve as non-public arbitrators if they otherwise qualify under Rule 10308(a)(4) of the Code. The proposed rule change would also amend the definition of “immediate family member’’ in Rule 10308(a)(5)(B) of the Code to add parents, children, stepparents, stepchildren, as well as any member of the arbitrator’s household.

The proposed rule change would also amend Rules 10308(d) and 10312(d) of the Code to provide that a challenge for cause will be granted where it is reasonable to infer an absence of impartiality, the presence of bias, or the existence of some interest on the part of the arbitrator in the outcome of the arbitration as it affects one of the parties. The interest or bias must be direct, definite, and capable of reasonable demonstration, rather than remote or speculative. In addition, the proposal would amend Rule 10308 of the Code to add a new paragraph (f) which would provide that close questions regarding arbitrator classification or challenges for cause brought by a public customer would be resolved in favor of the customer. Lastly, NASD proposed to amend Rule 10312(a) and (b) of the Code to clarify that arbitrators must disclose the required information and must make reasonable efforts to inform themselves of potential conflicts and update their disclosures as necessary.

III. Summary of Comments

As noted above, The Commission received eight comment letters on the proposal.[6] NASD submitted two letters in response to these comments.[7]

PIABA supported the proposal as a “positive and significant step toward the elimination of the appearance of pro-industry bias in the roster of those eligible to sit as ‘public’ arbitrators in NASD arbitrations.[8] PIABA, however, suggested that NASD consider further steps, such as eliminating all banking and insurance personnel from the public arbitrator pool, and categorizing all professional partners of all non-public arbitrators as non-public regardless of whether the partner’s firm meets the proposed 10% threshold under Rule 10308(a)(5)(A)(iv) of the Code.[9]

Some commenters believed that the proposed amendments to Rule 10308(a)(5)(A)(iv) of the Code to classify as non-public arbitrators an attorney, accountant or other professional whose firms derived more than 10 percent of its revenue from the industry in the last two years from securities industry clients is too lenient and should go farther.[10] NELA suggested that attorneys whose firm represent industry members

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 48347 (August 14, 2003), 68 FR 50563.

[4] *See* letters to Jonathan G. Katz, Secretary, Commission, from Joseph O’Donnell, dated July 16, 2003 (“O’Donnell Letter’’); Cliff Palefsky, Co-Chair, ADR Committee, National Employment Lawyers Association (“NELA’’), dated September 9, 2003 (“NELA Letter’’); Stephen G. Sneeringer, Senior Vice President and Counsel, A.G. Edwards & Sons, Inc., dated September 9, 2003 (“A.G. Edwards Letter’’); Edward Turan, Chair, Securities Industry Association (“SIA’’) Arbitration Committee, SIA, dated September 11, 2003 (“SIA Letter’’); Charles W. Austin, Jr., Vice-President/President Elect, Public Investor Arbitration Bar Association (“PIABA’’), dated September 11, 2003 (“PIABA Letter’’); James Dolan, Attorney and Counselor, dated October 8, 2003 (“Dolan Letter’’); and Richard P. Ryder, President, Securities Arbitration Commentator, Inc. (“SAC’’), dated October 23, 2003 (“SAC Letter’’). See also e-mail to *rules-comments@sec.gov* from *ProfLipner@aol.com* dated September 23, 2003 (“Lipner Letter’’).

[5] *See* letters to Florence Harmon, Senior Special Counsel, Division of Market Regulation (“Division’’), Commission, from Laura Ganzler, Counsel, NASD, dated September 30, 2003 and February 2, 2004 (“NASD’s Response’’).

[6] *See supra* note 4.

[7] *See supra* note 5.

[8] *See* PIABA Letter.

[9] *See* PIABA Letter.

[10] *See* NELA Letter, PIABA Letter.

should be classified as non-public arbitrators regardless of the dollar volume of the business because incentive to favor the industry is "too obvious too ignore."[11]

A.G. Edwards, although generally supportive of the proposed rule change, argued that to exclude from the definition of public arbitrator any "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 involved in the securities industry is too broad.[12] SAC also objected to this exclusion from the definition of public arbitrator.[13] They believed this provision could limit the depth of the NASD arbitrator pool and argue that excluding such persons from serving as public arbitrators is overly broad and not supported by clear evidence that such persons are actually biased in favor of the industry. A.G. Edwards suggested that the possible disclosure of revenue sources by potential arbitrators may also dissuade potential arbitrators from participating.[14] In response, NASD stated that it took this concern into account and has concluded that the amendment, if approved, will not adversely impact its ability to panel cases. NASD also disagrees that the proposed provision unnecessarily excludes categories of persons from serving as public arbitrators. In its response, NASD stated that the new provision is not intended to eliminate only persons with actual bias, but also persons who could reasonably be perceived to be biased. NASD pointed to a report by Professor Michael Perino which noted, "no classification rule could ever precisely define public and non-public arbitrators; there will always be classification questions at the margins about which reasonable people will differ."[15] Given the inherently imprecise nature of such definitions, NASD stated that to protect both the integrity of the NASD forum, and investors' confidence in the integrity of the forum, it prefers the definition of public arbitrator to be overly restrictive rather than overly permissive.

SAC also questioned why the proposal to exclude from the definition of public arbitrator any "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 involved in the securities industry differs from a similar provision adopted by the Securities Industry Conference on Arbitration ("SICA"), which would impose a 20% threshold.[16] NASD stated that it carefully considered SICA's proposal. However, NASD stated that the Board of Directors of NASD Dispute Resolution, Inc. and its National Arbitration and Mediation Committee concluded that the proposed rule change would best protect the integrity of the NASD forum from both the reality and perception of impartiality.

In addition, both SIA and A.G. Edwards specifically objected to the use of the terms "professional" and "firm" in proposed Rule 10308(a)(5)(A)(iv), which they argue are overly vague and overbroad. In response, NASD stated that it does not believe that the term "professional" or the term "firm" would prove to be problematic in practice. NASD noted that the term "professional" is used elsewhere in current Rule 10308 of the Code and has not been the source of confusion or controversy in the past. NASD sees no reason to believe that the use of the term "professional" or "firm" in the proposed provision will be any more problematic in practice than the use of the term "professional" or the term "business activities" elsewhere in the rule.

Mr. Dolan and SIA also argue that the proposed amendment to Rule 10308(a)(5)(B)(i) of the Code to include in the definition of family member the parent, child, stepparent, and stepchild of a person in the industry is too broad and would also severely reduce number of competent candidates eligible to serve as public arbitrators.[17] Mr. O'Donnell objected to including an arbitrator's "emancipated sons and daughters engaged in securities related work" in the proposed definition of family member and stated that this relationship should be disclosed but not be grounds for disqualification from the definition of public arbitrator.[18] In response, NASD stated that the proposed expansion of the definition of "immediate family member" was developed in light of the Perino Report, which recommended that NASD consider expanding the definition of "immediate family member" to include parents and children, even if the parent or child does not share a home with or receive substantial support from, a non-public arbitrator.[19] Although the Perino Report referred only to parents and children, NASD believes that the same rationale applies to stepparents and stepchildren and therefore proposed to include such relationships in the definition as well. NASD stated that it believes the expansion of the definition of "immediate family member" would enhance the overall fairness of NASD's arbitration forum, as well as the investing public's confidence in the fairness and integrity of the forum.

Mr. O'Donnell objected that the proposal excluded investment advisers from the definition of public arbitrators in Rule 10308(a)(5)(iii) of the Code.[20] Mr. O'Donnell further argued that the proposal failed to draw a distinction between "commission based" and "fee only" investment advisors and between independent investment advisors and those affiliated with a broker-dealer.[21] In response, NASD noted that the SICA adopted a similar amendment to its Uniform Code of Arbitration. NASD further stated that it believes the pool of qualified public arbitrators will remain deep and that the benefits of bolstering investor confidence in the integrity of the NASD arbitration process outweigh the loss of some individual investment advisers from the roster.

Lastly, Professor Lipner suggested that NASD bar all persons with ties to banks or related institutions from serving as public arbitrators.[22] NASD responded that it believes this suggestion is outside of the current proposal.

IV. Discussion

After careful consideration of the proposed rule change, the comment letters, and NASD's response, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association[23] and,

[11] *See* NELA Letter.

[12] *See* A.G. Edwards Letter. *See also* SIA letter. SIA stated that even though it believes the 10 percent threshold to be too low, that such a provision deems as pro-industry any person whose firm meets the 10 percent threshold and that this proposal would remove many members of the plaintiffs' bar employed by firms who represent broker-dealers in employment actions against their employers.

[13] *See* SAC Letter.

[14] *See* A.G. Edwards Letter.

[15] *See* Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations,* November 4, 2002 ("Perino Report").

[16] *See* SAC Letter.

[17] *See* Dolan Letter, SIA Letter.

[18] *See* O'Donnell Letter.

[19] *See* Perino Report, *supra* note 15. NASD clarified that when the "immediate family member" has not been associated with the securities industry for five years, as specified by Rule 10308(a)(4)(A) of the Code, the "immediate family member's" past affiliation would cease to be a basis to exclude an individual from serving as a public arbitrator pursuant to Rule 10308(a)(5)(A)(i) of the Code. Telephone conversation between Florence Harmon, Senior Special Counsel, Division, Commission, from Laura Ganzler, Counsel, NASD, on March 10, 2004.

[20] *See* O'Donnell Letter.

[21] *See* O'Donnell Letter.

[22] *See* Lipner Letter.

[23] In approving this proposed rule change, the Commission notes that it has considered its impact

in particular, the requirements of section 15A of the Act[24] and the rules and regulations thereunder. Specifically, the Commission believes that the proposed rule change is consistent with section 15A(b)(6) of the Act,[25] which, among other things, requires that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

At the Commission's request, Professor Michael Perino issued a report assessing the adequacy of NASD's and New York Stock Exchange, Inc.'s ("NYSE") arbitrator disclosure requirements and evaluating the impact of the recently adopted California Ethics Standards[26] on the current conflict disclosure rules of the self-regulatory organizations ("SROs").[27] The Perino Report recommended several amendments to SRO arbitrator classification and disclosure rules that, according to the Perino Report, might "provide additional assurance to investors that arbitrations are in fact neutral and fair." The Commission believes that this proposed rule change implements those recommendations, as well as several other related changes to the definition of public and non-public arbitrators that are consistent with the Perino Report recommendations.

Specifically, the Commission finds that NASD's proposal to amend the definition of non-public arbitrator in Rules 10308(a)(4) and 10308 (5)(A) of the Code is consistent with the Act. NASD's proposal, among other things, to exclude from the definition of public arbitrator attorneys, accountants, and other professionals whose firms have derived 10 percent or more of their annual revenue, in the last two years, from clients involved in the activities defined as non-public is reasonably designed to reduce a perception of bias by NASD arbitration panel members. Some commenters argued that professional partners of all persons described in Rule 10308(a)(4)(C) of the Code be categorized as non-public regardless of whether the partner's firm meets the proposed 10 percent threshold while others argued that the 10% threshold is too broad and will adversely impact the depth of the pool of potential arbitrators. NASD's proposal to expand the definition of "immediate family member" in Rule 10308(a)(5)(B) of the Code to include parents, stepparents, children, or stepchildren, as well as any member of the arbitrator's household is also consistent with the Act. Some commenters objected to this expansion of the definition of "immediate family member" stating that it too would reduce the number of competent candidates to serve as public arbitrators.

The Commission believes that NASD proposal to exclude from the definition of public arbitrator attorneys, accountants, and other professionals whose firms derived 10 percent or more of their annual revenue, in the last two years, from clients involved in the activities defined in the definition of non-public arbitrator is reasonably designed to reduce a perception of bias by NASD arbitration panel members. In addition, the Perino Report recommended that NASD consider an expansion of the definition of "immediate family member" to include parents and children, even if the parent or child do not share the same home or receive substantial support from a non-public arbitrator.[28] NASD considered the issue and determined to expand the term. The Commission also believes it is reasonable for NASD to further expand the definition of non-public arbitrator by including stepparents and step children as well as parents, children, and any household member in the definition of immediate family member. The Perino Report also noted that "no classification rule could ever precisely define public and non-public arbitrators; there will always be classification questions at the margins about which reasonable people will differ."[29] Thus, the Commission believes that the amendments to the definition of public arbitrator, including the 10 percent threshold and definition of "immediate family member" are consistent with the Act.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposal is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[30] that the proposed rule change (File No. SR–NASD–2003–95) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[31]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 04–9163 Filed 4–21–04; 8:45 am]

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on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[24] 15 U.S.C. 78*o*–3.

[25] 15 U.S.C. 78*o*–3(b)(6).

[26] *See* California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration."

[27] *See* Perino Report, *supra* note 15.

[28] *See id.*

[29] *See id.*

[30] 15 U.S.C. 78s(b)(2).

[31] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49569; File No. SR–PCX–2004–26]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 by the Pacific Exchange, Inc. To Clarify the PCX General Membership Fees Portion of the PCX Schedule of Fees and Charges

April 15, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on April 6, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On April 14, 2004, the Exchange amended the proposed rule change.[3] The Exchange filed the proposal pursuant to section 19(b)(3)(A) of the Act,[4] and Rule 19b–4(f)(6)[5] thereunder, which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

[2] 17 CFR 240.19b–4.

[3] *See* April 13, 2004 letter from Tania J.C. Blanford, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, and attachments ("Amendment No. 1"). Amendment No. 1 completely replaced and superseded the original proposed rule change. In Amendment No. 1, the PCX asks the Commission to review the proposed rule change pursuant to section 19(b)(3)(A) of the Act and Rule 19b–4(f)(6) thereunder. The Commission considers the original proposed rule change to have satisfied the five-day pre-filing notice requirement under Rule 19b–4(f)(6). Additionally, for purposes of calculating the 60-day abrogation period, the Commission considers the proposed rule change to have been filed on April 14, 2004, the day the PCX filed Amendment No. 1. 17 CFR 240.19b–4(f)(6).

[4] 15 U.S.C. 78s(b)(3)(A).

[5] 17 CFR 240.19b–4(f)(6).