

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51213; File No. SR-NASD-2004-180]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding Waiver of California Arbitrator Disclosure Standards

February 16, 2005.

#### I. Introduction

On December 9, 2004, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission"), 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> a proposed rule change relating to the waiver of California Arbitrator Disclosure Standards. The proposed rule change was published for comment in the *Federal Register* on January 14, 2005.<sup>3</sup> For the reasons discussed below, the Commission is approving the proposed rule change.

#### II. Description of the Proposed Rule Change

##### A. Description of the Proposal

Effective July 1, 2002, the California Judicial Council adopted a set of rules, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" ("California Standards"),<sup>4</sup> which contain extensive disclosure requirements for arbitrators. According to NASD, the rules were designed to address conflicts of interest in private arbitration forums that are not part of a federal regulatory system overseen on a uniform, national basis by the SEC. NASD states that the California Standards impose disclosure requirements on arbitrators that conflict with the disclosure rules of NASD and the New York Stock Exchange ("NYSE"). Because NASD could not both administer its arbitration program in accordance with its own rules and comply with the new California Standards at the same time, NASD initially suspended the appointment of arbitrators in cases in California, but offered parties several options for pursuing their cases.<sup>5</sup> In response to the

adoption of the California Standards and the conflict between the California Standards and the NASD Rules, NASD, the NYSE, and other claimants filed various actions in both the federal court system and the California state court system. These cases are presently proceeding through both the California and the federal court systems.<sup>6</sup>

To allow arbitrations to proceed in California while the litigation regarding the applicability of the California Standards to SRO arbitrations is pending, NASD implemented a pilot rule to require all industry parties (member firms and associated persons) to waive application of the California Standards to the case, if all the parties in the case who are customers, associated persons with claims against industry parties, member firms with claims against other member firms, or member firms with claims against associated persons that relate exclusively to promissory notes, have done so.<sup>7</sup>

The pilot rule, which was originally approved for six months on September 26, 2002,<sup>8</sup> has been extended and is now due to expire on March 31, 2005.<sup>9</sup> NASD believes all the pending litigation regarding the California Standards is unlikely to be resolved by March 31, 2005. The Commission is approving NASD's request to extend the effectiveness of the pilot rule through September 30, 2005, in order to permit

arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.

<sup>6</sup> For a more complete discussion of the various pending cases, please see the Notice, *supra* note 3.

<sup>7</sup> Originally, the pilot rule applied only to claims by customers, or by associated persons asserting a statutory employment discrimination claim against a member, and required a written waiver by the industry respondents. In July 2003, NASD expanded the scope of the pilot rule to include all claims by associated persons against another associated person or a member. At the same time, the rule was amended to provide that when a customer, or an associated person with a claim against a member or another associated person, agrees to waive the application of the California Standards, all respondents that are members or associated persons will be deemed to have waived the application of the standards as well. The July 2003 amendment also clarified that the pilot rule applies to terminated members and associated persons. See Securities Exchange Act Release No. 48187 (July 16, 2003), 68 FR 43553 (July 23, 2003) (SR-NASD-2003-106). In October 2003, NASD again expanded the scope of the pilot rule to include claims filed by members against other members and to claims filed by members against associated persons that relate exclusively to promissory notes. See Securities Exchange Act Release No. 48711 (October 29, 2003), 68 FR 62490 (November 4, 2003) (SR-NASD-2003-153).

<sup>8</sup> See Securities Exchange Act Release No. 46562 (September 26, 2002), 67 FR 62085 (October 3, 2002) (SR-NASD-2002-126).

<sup>9</sup> See Securities Exchange Act Release No. 50447 (September 24, 2004), 69 FR 58567 (September 30, 2004) (SR-NASD-2004-126).

NASD to avoid disrupting the administration of cases covered by the pilot rule under the NASD Code of Arbitration Procedure.

##### B. Comment Summary

The proposal was published for comment in the *Federal Register* on January 14, 2005.<sup>10</sup> We received no comments on the proposal.

#### III. Discussion and Findings

The Commission finds the proposed rule change is consistent with the Act, and in particular with section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.<sup>11</sup> The Commission believes that the proposed rule change is consistent with the provisions of the Act noted above because, in the event that the pending litigation regarding the California Standards is not resolved by March 31, 2005, the current pilot expiration date, the extension of the effectiveness of the pilot rule through September 30, 2005, will permit NASD to avoid disrupting the administration of cases covered by the pilot rule under the NASD Code of Arbitration Procedure. The Commission believes that NASD's current system provides an appropriate forum for the resolutions of cases covered by the pilot rule. Under the pilot rule, the arbitration proceeds under the NASD Code of Arbitration Procedure, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.<sup>12</sup> The Commission believes that the extension of the pilot rule will provide claimants with a continuing, consistent, and appropriate forum in which to arbitrate their claims, allowing claimants to proceed rather than requiring them to suspend their claims until the litigation is completed. The Commission believes that providing claimants with such a forum is consistent with the protection of investors and the public interest.

#### IV. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act<sup>13</sup> that the proposed rule change (SR-NASD-2004-

<sup>10</sup> See note 3, *supra*.

<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

<sup>12</sup> NASD notes that the NYSE has a similar rule, NYSE Rule 600(g).

<sup>13</sup> 15 U.S.C. 78s(b)(2).

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

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

<sup>3</sup> Securities Exchange Act Release No. 50971 (January 6, 2005), 70 FR 2685 (January 14, 2005) (the "Notice").

<sup>4</sup> California Rules of Court, Division VI of the Appendix.

<sup>5</sup> These measures included providing venue changes for arbitration cases, using non-California

180) be, and hereby is, approved through September 30, 2005.<sup>14</sup>

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51214; File No. SR-NASD-2005-014]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Revisions to the Series 11 Examination Program

February 16, 2005

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 January 31, 2005, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in items I, II and III below, which items have been prepared by NASD. NASD filed this proposal pursuant to section 19(b)(3)(A)(i)<sup>3</sup> of the Act and Rule 19b-4(f)(1) thereunder,<sup>4</sup> which renders the proposal 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

NASD is filing revisions to the study outline and selection specifications for the Assistant Representative—Order Processing (Series 11) examination program.<sup>5</sup> The proposed revisions

<sup>14</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

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

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

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

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

<sup>5</sup> NASD also is proposing corresponding revisions to the Series 11 question bank, but based upon instruction from the Commission staff, NASD is filing SR-NASD-2005-014 for immediate effectiveness, and is not filing the question bank for Commission review. See letter to Alden S. Adkins, Senior Vice President and General Counsel, NASD Regulation, from Belinda Blaine, Associate Director, Division of Market Regulation, SEC, dated July 24,

update the material to reflect changes to the laws, rules, and regulations covered by the examination. NASD is not proposing any textual changes to the By-Laws, Schedules to the By-Laws, or Rules of NASD.

The revised study outline is available at NASD and at the Commission. However, NASD has omitted the Series 11 selection specifications from this filing and has submitted the specifications under separate cover to the Commission with a request for confidential treatment pursuant to Rule 24b-2 under the Act.<sup>6</sup>

#### 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 its proposal and discussed any comments it received regarding the proposal. 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

Pursuant to section 15A(g)(3) of the Act,<sup>7</sup> which requires NASD to prescribe standards of training, experience, and competence for persons associated with NASD members, NASD has developed examinations, and administers examinations developed by other self-regulatory organizations, that are designed to establish that persons associated with NASD members have attained specified levels of competence and knowledge. NASD periodically reviews the content of the examinations to determine whether revisions are necessary or appropriate in view of changes pertaining to the subject matter covered by the examinations.

The Series 11 examination qualifies an individual to function as an assistant representative to accept unsolicited securities orders from existing customers of a member firm. A Series 11 assistant representative may not solicit transactions or new accounts on behalf of the member, render investment advice, make recommendations to customers regarding the appropriateness

of securities transactions, or effect transactions in securities markets on behalf of the member. Further, a Series 11 assistant representative may not be registered concurrently in any other capacity. A committee of industry representatives, together with NASD staff, recently undertook a review of the Series 11 examination program. As a result of this review, NASD is proposing revisions to the examination program to reflect changes to the laws, rules, and regulations covered by the examination, to include new securities products, such as exchange-traded funds, and to focus the examination more on the handling of customer accounts and orders. Based on these revisions, the title of Section 2 was changed from "Processing Customer Orders; Providing Price Information; and Order Processing" to "Customer Accounts and Orders." NASD is further proposing revisions to the study outline to reflect the new SEC short sale requirements.<sup>8</sup> In addition, the number of questions on each section of the study outline were modified as follows: Types of Securities, decreased from 11 to 10 questions; Customer Accounts and Orders, increased from 19 to 24 questions; Securities Markets, decreased from 8 to 5 questions; and Securities Industry Regulations, decreased from 12 to 11 questions.

NASD is proposing similar changes to the corresponding sections of the Series 11 selection specifications and question bank. The number of questions on the Series 11 examination will remain at 50, and candidates will have one hour to complete the exam. Also, each question will continue to count one point, and each candidate must correctly answer 70 percent of the questions to receive a passing grade.

###### 2. Statutory Basis

NASD believes that the proposed revisions to the Series 11 examination program are consistent with the provisions of sections 15A(b)(6)<sup>9</sup> and 15A(g)(3) of the Act,<sup>10</sup> which authorize NASD to prescribe standards of training, experience, and competence for persons associated with NASD members.

##### 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.

2000. The question bank is available for Commission review.

<sup>6</sup> CFR 240.24b-2.

<sup>7</sup> U.S.C. 78o-3(g)(3).

<sup>8</sup> Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004)(S7-23-2003).

<sup>9</sup> U.S.C. 78o-3(b)(6).

<sup>10</sup> U.S.C. 78o-3(g)(3).