

19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon receipt of this filing by 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 proposes to amend the pilot rule in IM-10100(f) and (g) of the NASD Code of Arbitration Procedure to expand and clarify the scope of the requirement that industry parties waive application of the contested California Arbitrator Disclosure Standards upon the request of customers or associated persons. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

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10000. Code of Arbitration Procedure

IM-10100. Failure To Act Under Provisions of Code of Arbitration Procedure

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member or a person associated with a member to:

(a)-(e) No change.

(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if all the parties in the case who are customers, or associated persons with a claim against a member firm or another associated person, have waived application of the California Standards in that case. *The written waiver by the customer or the associated person asserting the claim against a member or associated person under the Code shall constitute and operate as a waiver for all member firms or associated persons against whom the claim has been filed. This rule applies to claims brought in California against all member firms and associated persons, including terminated or otherwise inactive member firms or associated persons.* [; or

(g) fail to waive the California Standards, if all the parties in the case who are associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived

application of the California Standards in that case.] Remainder unchanged.

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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 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. 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

Background

On July 1, 2002, California introduced new rules governing the arbitration process in that state. 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. The California Standards conflict with NASD's current arbitrator disclosure rules. 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.⁵

In September 2002, NASD proposed implementation on an accelerated basis of a six-month pilot amendment to IM-10100 that would require all parties that are member firms or associated persons to waive the California Standards if all the parties in the case who are customers, or associated persons with a statutory employment discrimination claim, have waived application of the California Standards in that case. Under such a waiver, the case would proceed in California. The Commission approved the proposed rule change for a six-month period ending March 30, 2003,⁶ and recently extended the pilot

rule for an additional six-month period.⁷ The pilot rule will expire on September 30, 2003.

Description of Proposed Rule Change

The proposed rule change would amend the pilot rule in several respects. First, it would extend the rule to apply to all claims by an associated person against a member firm or another associated person, as well as to all customer claims. Currently, the pilot rule only applies to customer claims and to statutory discrimination claims brought by an associated person against a member firm. As a result, cases involving other claims by associated persons against member firms or other associated persons ("industry respondents") cannot proceed if the industry respondents do not agree to waive the California Standards. To permit these cases to move forward, the proposed rule change would expand the current pilot rule to require that if an associated person with a claim against an industry respondent waives the application of the California Standards, all other industry respondents must also waive the application of the California Standards in that case. This change is consistent with New York Stock Exchange Rule 600(g), and would permit claims by associated persons against industry respondents in California to go forward.

The proposed rule change would also provide that, if a customer, or an associated person with a claim against an industry respondent, agrees to waive the application of the California Standards, and an industry respondent has not signed and returned a waiver form, the industry respondent will be deemed to have waived the application of the standards in that case. Currently, NASD requires member firms and associated persons covered by the rule to sign and return the waiver agreement. NASD staff often must call industry respondents to remind them to send in their waiver forms. When execution of the agreement by the respondent member or associated person is mandatory under the rule, this requirement adds an unnecessary administrative step to the arbitration process. Therefore, NASD is proposing to amend the pilot rule to provide, as NYSE Rule 600(g) currently does, that a written waiver by a customer or an associated person who is asserting a claim against a member or associated person under the Code will constitute a waiver for all member firms or

⁴ 17 CFR 240.19b-4. In its filing, NASD requested that the Commission waive the rule's requirements of a five-day pre-filing notice and a 30-day operative delay.

⁵ These measures included providing venue changes for arbitration cases, using non-California arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.

⁶ See Securities Exchange Act Release No. 46562 (September 26, 2002), 67 FR 62085 (October 3, 2002).

⁷ See Securities Exchange Act Release No. 47631 (April 3, 2002) 68 FR 17713 (April 10, 2003).