

Phlx Memo No. 1840-07

RC No: NASD- 2007-21

MEMORANDUM

To: Members and Member Organizations

From: Legal Department

Date: July 26, 2007

Re: NASD Code of Arbitration
SR-NASD-2007-21 Notice of Filing of Proposed Rule Change To Amend
the Definition of Public Arbitrator

Pursuant to Phlx Rule 950, Section 44, the Exchange has outsourced its arbitration and mediation program to NASD Dispute Resolution. The purpose of this memo is to update you as to proposed amendments to the NASD Code of Arbitration Procedure.

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 ("SEC" or "Commission") on March 12, 2007.

The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons. The text of the proposed rule change is available at NASD, <http://www.nasd.com>, and the Commission's Public Reference Room.

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.

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.

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. Several of the substantive changes to the Customer and Industry Codes will affect the classification of arbitrators and how they are selected for panels.

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.

NASD believes the proposed amendment, in conjunction with the existing 10 percent revenue limitation, 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.

The text of the proposed rule change is available on NASD's Web site (<http://www.nasd.com>), at NASD's principal office, and at the Commission's Public Reference Room.

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. 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 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. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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**.

If you have any questions regarding this proposed rule change, or would like a complete copy of this proposed filing, or further questions regarding the NASD Dispute Resolution Process, please click on the NASD Dispute Resolution website at www.nasdadr.com. If you need additional help, please contact Scott Donnini at (215) 496-5358.