

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to file number SR-Amex-2002-22 and should be submitted by April 24, 2002.

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

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45652; File No. SR-MSRB-2002-03]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Professional Qualifications of Municipal Fund Securities Limited Principals

March 26, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder,¹ notice is hereby given that on March 21, 2002, the Municipal Securities Rulemaking Board ("MSRB") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-MSRB-2002-03) ("proposed rule change") described in Items I, II, and III below, which Items have been prepared by the MSRB. 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 MSRB has filed with the Commission a proposed rule change consisting of an amendment to Rule G-3, on professional qualifications. Additions are italicized; deletions are bracketed. The proposed rule change is as follows:

Rule G-3—Classification of Principals and Representatives; Numerical Requirements; Testing; Continuing Education Requirements

(a) No change.

(b) Municipal Securities Principal; *Municipal Fund Securities Limited Principal.*

(i) No change.

(ii) Qualification Requirements.

(A) No change.

(B) Any person seeking to become qualified as a municipal securities principal in accordance with subparagraph (b)(ii)(A) of this rule[,] must, prior to being qualified as a municipal securities principal:

(1) Have been duly qualified as either a municipal securities representative or a general securities representative; *provided, however, that any person who qualifies as a municipal securities representative solely by reason of subparagraph (a)(ii)(C) shall not be qualified to take the Municipal Securities Principal Qualification Examination on or after October 1, 2002; or*

(2) No change.

(C)-(D) No change.

(iii) No change.

(iv) *Municipal Fund Securities Limited Principal.*

(A) *Definition.* The term "municipal fund securities limited principal" means a natural person (other than a municipal securities principal or municipal securities sales principal), associated with a broker, dealer or municipal securities dealer that has filed with the Board in compliance with rule A-12, who is directly engaged in the functions of a municipal securities principal as set forth in paragraph (b)(i), but solely as such activities relate to transactions in municipal fund securities.

(B) *Qualification Requirements.*

(1) *Every municipal fund securities limited principal shall take and pass the Municipal Fund Securities Limited Principal Qualification Examination prior to being qualified as a municipal fund securities limited principal. The passing grade shall be determined by the Board.*

(2) *Any person seeking to become qualified as a municipal fund securities limited principal in accordance with clause (b)(iv)(B)(1) of this rule must, as a condition to being qualified as a municipal fund securities limited principal:*

(a) *have been duly qualified as either a general securities principal or an investment company/variable contracts limited principal; or*

(b) *have taken and passed either the General Securities Principal Qualification Examination or the Investment Company and Annuity Principal Qualification Examination.*

(3) *Any person who ceases to act as a municipal fund securities limited principal for two or more years at any time after having qualified as such shall meet the requirements of clauses (b)(iv)(B)(1) and (2) prior to being qualified as a municipal fund securities limited principal.*

(4) *For the first 90 days after becoming a municipal fund securities limited principal, the requirements of clauses (b)(iv)(B)(1) and (2) shall not apply to any person who is qualified as a general securities representative, investment company/variable contracts limited representative, general securities principal or investment company/variable contracts limited principal, provided, however, that such person shall meet the requirements of clauses (b)(iv)(B)(1) and (2) within that period.*

(C) *Actions as Municipal Securities Principal.* Any municipal fund securities limited principal may undertake all actions required or permitted under any Board rule to be taken by a municipal securities principal, but solely with respect to activities related to municipal fund securities.

(D) *Numerical Requirements.* Any broker, dealer or municipal securities dealer whose municipal securities activities are limited exclusively to municipal fund securities may count any municipal fund securities limited principal toward the numerical requirement for municipal securities principal set forth in paragraph (b)(iii).

(E) [(iv)] *Temporary Provisions for Municipal Fund Securities Limited Principal.* Notwithstanding any other provision of this rule, until December 31, 2002, [Until July 31, 2002,] the following provisions shall apply to any broker, dealer or municipal securities dealer whose municipal securities activities are limited exclusively to municipal fund securities:

[(A)] (1) [notwithstanding the provisions of paragraph (b)(ii),] the broker, dealer or municipal securities dealer may designate any person who

¹ 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4 thereunder.

has taken and passed the General Securities Principal Qualification Examination or Investment Company and Annuity Principal Qualification Examination as a municipal fund securities limited principal.

[(B)] (2) any municipal fund securities limited principal designated as provided in *clause* [subparagraph] (b)(iv)[(A)] (*E*)(1) may undertake all actions required or permitted under any Board rule to be taken by a municipal securities principal *to the same extent as set forth in subparagraph (b)(iv)(C)*.

[(C)] (3) the broker, dealer or municipal securities dealer may count [one] any municipal fund securities limited principal *designated as provided in clause (b)(iv)(E)(1)* toward the numerical requirement for municipal securities principal *to the same extent as set forth in subparagraph (b)(iv)(D)*. [set forth in paragraph (b)(iii); provided that, if such broker, dealer or municipal securities dealer is only required to have one municipal securities principal, such broker, dealer, or municipal securities dealer may count one municipal fund securities limited principal toward the numerical requirement only if the broker, dealer or municipal securities dealer is described in subparagraph (b)(iii)(B).]

(4) *On and after January 1, 2003, all municipal fund securities limited principals (including any municipal fund securities limited principals designated as provided in clause (b)(iv)(E)(1)) must be qualified as provided in subparagraph (b)(iv)(B).*

(c)-(f) No change.

(g) Waiver of Qualification Requirements.

(i) The requirements of paragraphs (a)(ii), (a)(iii), (b)(ii), (b)(iv)(B) and (c)(ii) may be waived in extraordinary cases for any associated person of a broker, dealer or municipal securities dealer who demonstrates extensive experience in a field closely related to the municipal securities activities of such broker, dealer or municipal securities dealer. Such waiver may be granted by (A)-(B) No change.

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 MSRB 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 MSRB 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

(a) Rule G-3, on professional qualifications, requires that a broker, dealer or municipal securities dealer ("dealer") have at least one municipal securities principal (and in some cases two municipal securities principals), even if the dealer's only municipal securities transactions are sales of municipal fund securities.² In order to provide small dealers seeking to enter the market for municipal fund securities relief from the requirement to immediately obtain a municipal securities principal, the MSRB amended Rule G-3 in July 2001 to provide a temporary alternative method for qualification of principals in connection with municipal fund securities.³ Under this temporary provision, until July 31, 2002, if a dealer's municipal securities activities are limited exclusively to municipal fund securities and the dealer has fewer than 11 associated persons engaged in such activities, it may fulfill its obligation to have a municipal securities principal by designating a general securities or investment company/variable contracts limited principal to act as a limited principal.⁴ During this period, any designated limited principal has all of the powers and responsibilities of a municipal securities principal under MSRB rules with respect to transactions in municipal fund securities. Under the current transition provision, on and

² A municipal fund security is defined in MSRB's Rule D-12 as a municipal security issued by an issuer that, but for Section 2(b) of the Investment Company Act of 1940 (the "Investment Company Act"), would constitute an investment company within the meaning of the Investment Company Act. Section 2(b) exempts states and political subdivisions, and agencies, authorities, and instrumentalities thereof, from the Investment Company Act.

³ See SR-MSRB 2001-05; Exchange Act Release No. 44584 (July 23, 2001); 66 FR 39541 (July 31, 2001).

⁴ Dealers that have 11 or more associated persons engaged in municipal fund securities activities may also designate a general securities or investment company/variable contracts limited principal to act as a limited principal. If a dealer is required to have two municipal securities principals under Rule G-3(b)(iii), then it may count one such limited principal toward this numerical requirement but must still have one municipal securities principal qualified other than by reason of being a general securities or investment company/variable contracts limited principal. If any dealer having 11 or more associated persons engaged in municipal fund securities activities is permitted to have only one municipal securities principal by virtue of Rule G-3(b)(iii)(A), the numerical requirements may not be satisfied by designation of a limited principal.

after August 1, 2002, dealers effecting transactions in municipal fund securities are required to comply with the same municipal securities principal requirements applicable to all other dealers effecting transactions in municipal securities.

The MSRB understands that many dealers that wish to participate in the market for municipal fund securities do not currently, and do not plan to, engage in any municipal securities activities other than with respect to municipal fund securities. Since these dealers will not participate in the market for municipal debt securities and the features of municipal fund securities differ significantly from those of debt securities, the MSRB believes that no investor protection purpose is served by requiring principals responsible for supervision of such firms' municipal fund securities activities to demonstrate their understanding of the application of MSRB rules other than with respect to municipal fund securities.

Thus, the MSRB is proposing the creation of a new category of principals to serve permanently as municipal fund securities limited principals. Qualification as a municipal fund securities limited principal would be by an examination consisting of questions on the broad range of MSRB-specific topics that are relevant to municipal fund securities activities.⁵ The examination would require that the individual taking it have previously or concurrently taken and passed the general securities principal qualification examination (Series 24) or investment company and annuity principal qualification examination (Series 26) administered by the National Association of Securities Dealers, Inc. ("NASD"). The qualification examination for municipal fund securities limited principals is scheduled to become available on October 1, 2002. MSRB staff is currently in the process of developing the qualification examination and will file the study outline and specifications with the Commission under separate cover.

An individual qualified as a municipal fund securities limited principal would be permitted to supervise only the municipal fund securities activities of the dealer and would have no authority to supervise the activities of the dealer with respect

⁵ Since the qualification examination would be tailored specifically to the application of MSRB rules to municipal fund securities, rather than to all types of municipal securities, the MSRB expects that this examination would not be as lengthy as the existing qualification examination for municipal securities principals (Series 53).

to any other type of municipal securities. However, an individual qualified as a municipal securities principal (Series 53) would continue to be qualified to supervise all municipal securities activities of the dealer, including activities relating to municipal fund securities. Thus, an individual wishing to supervise municipal fund securities activities could qualify to do so either (i) by becoming a municipal securities principal through the municipal securities principal qualification examination (Series 53) or (ii) by becoming a municipal fund securities limited principal through this new qualification examination if the individual is already or concurrently becomes a general securities or investment company/variable contracts limited principal.

If a dealer's municipal securities activities are limited to municipal fund securities, the proposed rule change also would count all municipal fund securities limited principals toward the numerical requirement for principals regardless of the number of associated persons engaging in such activities. Thus, any dealer that does not engage in any municipal securities activities other than with respect to municipal fund securities could fully discharge its obligation with respect to municipal securities principals with individuals qualified as municipal fund securities limited principals.

Further, existing rule language indirectly permits investment company/variable contracts limited representatives (Series 6) to take the Series 53 examination to become qualified as municipal securities principals.⁶ Although this was appropriate when there was no other provision under Rule G-3 for qualifying a principal to supervise municipal fund securities activities, the proposed rule change discontinues this method of qualification on October 1, 2002 when the new municipal fund securities limited principal qualification examination becomes available.⁷ An investment company/variable contracts

limited representative would be able to qualify as a municipal fund securities limited principal by taking both the Series 26 examination and the new municipal fund securities limited principal examination.

In addition, the proposed rule change extends the existing temporary provision permitting general securities principals and investment company/variable contracts limited principals to supervise municipal fund securities activities from July 31, 2002 to December 31, 2002 in order to provide dealers with an adequate opportunity to prepare potential candidates for the new examination. During this extended transition period, the numerical requirement with respect to principals would be simplified so that all dealers, not just those with fewer than 11 associated persons engaged in municipal fund securities activities, could fully meet their principal requirements with principals acting in the temporary capacity permitted under the transition provisions. The proposed rule change makes clear that, beginning on January 1, 2003, all municipal fund securities limited principals (including general securities principals and investment company/variable contracts limited principals supervising municipal fund securities activities under the temporary transition period who wish to continue such supervisory activities after December 31, 2002) must be qualified by taking the new qualification examination.

Finally, the proposed rule change would give the NASD or any other appropriate regulatory agency the power to waive qualification requirements with respect to municipal fund securities limited principals, as with all other qualification categories. As provided in Rule G-3(g)(i), such waivers are to be granted solely in extraordinary cases.

(b) The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2)(A) of the Exchange Act, which provides that it is the MSRB's responsibility to propose and adopt rules which:

provide that no municipal securities broker or municipal securities dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security unless * * * such municipal securities broker or municipal securities dealer and every natural person associated with such municipal securities broker or municipal securities dealer meets such standards of training, experience, competence, and such other qualifications as the Board finds necessary or appropriate in the public interest or for the protection of investors.

Section 15B(b)(2)(A) of the Exchange Act also provides that the MSRB may appropriately classify municipal securities brokers and municipal securities dealers and their associated personnel and require persons in any such class to pass tests prescribed by the MSRB.

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

The MSRB does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

On December 19, 2001, the MSRB published for comment a draft amendment designed to establish a permanent category of municipal fund securities limited principals and to establish permanent professional qualification requirements for dealers that limit their municipal securities activities to municipal fund securities. A municipal fund securities limited principal would have the same authority as a municipal securities principal under MSRB rules, but only with respect to municipal fund securities activities. A general securities principal or an investment company/variable contracts limited principal could qualify as a municipal fund securities limited principal by passing a new qualification examination relating specifically to municipal fund securities.⁸ The draft amendment would allow any dealer that limits its municipal securities activities to municipal fund securities, regardless of size, to comply with Rule G-3's numerical requirement for principals solely with municipal fund securities limited principals that have passed the new exam. In addition, the draft amendment would make explicit an existing provision that implicitly allows an investment company/variable contracts limited representative to take the Series 53 exam without first taking the municipal securities representative qualification examination (Series 52).

The MSRB received comments from seven commentators.⁹ After reviewing

⁶ Rule G-3 permits an investment company/variable contracts representative to act as a municipal securities representative solely with respect to municipal fund securities.

⁷ Qualification of an investment company/variable contracts limited representative as a full municipal securities principal allows that individual to supervise any securities activities, including debt securities. The MSRB is concerned that an individual who is solely qualified as an investment company/variable contracts limited representative prior to becoming a municipal securities principal may not have an adequate understanding of municipal debt securities to provide effective supervision under all circumstances.

⁸ A general securities representative (Series 7) or investment company/variable contracts limited representative (Series 6) also could qualify as a municipal fund securities limited principal by simultaneously passing the new qualification examination and either the general securities principal or investment company principal examination.

⁹ Letter from Erich Sokolower, Repex & Co., Inc. ("Repex"), to the MSRB, dated January 11, 2002;

these comments, the MSRB approved the draft amendment, with certain modifications, for filing with the Commission.¹⁰ The comments and the MSRB's responses are discussed below.

AG Edwards, ICI and TBMA support the draft amendment. ICI commends the MSRB for "continuing to tailor its regulatory requirements applicable to municipal fund securities in a manner that recognizes the differences between such securities and traditional municipal securities." TBMA states that the draft amendment "appropriately tailors registration requirements to the nature of the business conducted and provides firms with needed flexibility in adapting their compliance programs as their business evolves." AG Edwards states, "the new limited principal category is an appropriate vehicle whereby persons whose activities are limited to the supervision of municipal fund securities activities may be qualified to supervise those activities."

However, both AG Edwards and TBMA are concerned that the draft amendment might suggest that municipal securities sales principals (Series 8 or Series 9/10) may not supervise sales activities with respect to municipal fund securities and request clarification to the contrary. The MSRB wishes to make clear that it does not intend to limit the power of municipal securities sales principals to supervise sales activities with respect to municipal fund securities by creating the new municipal fund securities limited principal classification.

letter from Tamara K. Reed, Associate Counsel, Investment Company Institute ("ICI"), to Ernesto A. Lanza, Senior Associate General Counsel of the MSRB, dated January 15, 2002; letter from Gabriel Borthwick, Compliance Consultant and Molly Diggins, Attorney, Metropolitan Life Insurance Company ("MetLife"), to Ernesto A. Lanza, dated January 18, 2002; letter from Vincent S. Comperatore, Principal, VBC Securities, LLC ("VBC"), to Ernesto Lanza, dated January 23, 2002; letter from E. Allen Cole, VP—Compliance Counsel, A.G. Edwards & Sons, Inc. ("AG Edwards"), to Ernesto A. Lanza and Jill C. Funder, Assistant General Counsel of the MSRB, dated January 24, 2002; letter from Warren A. Forest, President, Forest Brokerage Advisers, Inc. ("Forest"), to Ernesto Lanza, dated January 25, 2002; and letter from John M. Ramsey, The Bond Market Association ("TBMA"), to Ernesto A. Lanza, dated January 28, 2002.

¹⁰ After reviewing the comments and further considering existing professional qualification provisions under Rule G-3, the MSRB modified the draft amendment by (i) establishing a time frame for implementing the new municipal fund securities limited principal qualification examination, (ii) extending the temporary transition period to December 31, 2002 and simplifying the numerical requirement to permit dealers to make appropriate preparations for qualification under the new category, (iii) phasing out the ability of investment company/variable contracts limited representatives to take the Series 53 examination, and (iv) allowing waivers of the qualification requirements for this category in extraordinary cases.

However, municipal securities sales principals may undertake only certain limited types of supervisory functions relating to sales activities in satisfaction of MSRB rules. Many supervisory responsibilities under MSRB rules must be undertaken by municipal securities principals or, in the case of municipal fund securities activities, by municipal fund securities limited principals.

Forest, MetLife, Repex and VBC oppose the draft amendment. MetLife argues that the differences between municipal fund securities and registered investment company securities that justify the need for regulation in this market should be addressed by issuer regulation rather than dealer regulation. MetLife states that "guiding issuers toward thorough documentation of unique aspects of their municipal fund offerings would help to better educate both the selling agents and the purchasers as to differences among plans—a result that we believe would ultimately be more effective than the addition of a back-office limited principal." MetLife further states, "these issues are better addressed by the selling agent or by field office series 26 or 24 registered principals who are closer to the point of sale, with more applicable knowledge to lend to the review process." MetLife recommends that "the MSRB not create a limited municipal securities principal category to address issues that . . . would be better resolved at the issuer level."

The MSRB understands MetLife's concern that some issues relating to municipal fund securities might best be resolved through issuer regulation. However, the MSRB has no authority with respect to issuers; rather, the MSRB is charged with protecting investors through dealer regulation.¹¹ Since MSRB rules do apply to dealers' municipal fund securities activities, the MSRB believes that the ultimate supervision of such activities must be conducted by someone who knows these rules. Contrary to MetLife's characterization of the municipal fund securities limited principal as a "back-office limited principal," the municipal fund securities limited principal would provide dealers with a second (and in many cases easier) means of fulfilling the appropriate top-level supervisory requirement established under MSRB rules which otherwise would be met by

¹¹ Because issuers of municipal fund securities are state or local governmental entities, the Commission has restricted regulatory authority over such issuers under the Securities Act of 1933, the Exchange Act and the Investment Company Act. The NASD's dealer rules also do not apply to municipal fund securities because they are issued by state or local governmental entities.

a municipal securities principal. With regard to personnel at the point of sale, dealers are permitted under Rule G-3 to use investment company/variable contracts limited representatives to sell municipal fund securities and sales principals to directly supervise such sales activities.

Forest, Repex and VBC believe that the draft amendment would increase their regulatory burden. VBC mistakenly believes that its general securities principals are currently qualified to supervise municipal securities activities and should also be qualified to supervise municipal fund securities activities. VBC states that the "new proposal would require more testing and sure to follow CE credits. This is unjust, too time consuming and unnecessary." Repex views the qualification provisions as an "absolutely new burden on industry & reps: entirely unnecessary" and believes that "more of these rules will force more of the smaller firms to leave the business." Forest argues that dealers conducting business in municipal fund securities should not be required to become members of the MSRB, noting that dealers that are "not currently approved to conduct municipal securities business, would have to enter into a Membership Continuance Request under NASD Membership Rule 1017. This is an arduous, time consuming and expensive process that would be especially felt by smaller Broker/Dealers." Forest also argues that dealers selling securities similar to municipal fund securities, such as mutual fund IRA accounts and municipal bond mutual funds, are not required to be registered with the MSRB.

The MSRB believes that the proposed rule change would in fact decrease dealers' regulatory burden. Without the amendment, dealers would be required to use fully qualified municipal securities principals to meet their Rule G-3 principal requirement. As stated above, the creation of the municipal fund securities limited principal category provides dealers with an alternative means of meeting this requirement. For dealers that do not otherwise engage in municipal securities activities, allowing their general securities principals or investment company principals to take a shorter, more focused examination than the Series 53 exam in order to qualify as a municipal fund securities principal should be less burdensome. The further reduction in regulatory burden that these commentators most likely desire—i.e., no MSRB qualification requirements—is inappropriate since activities regulated

by MSRB rules require ultimate supervision by someone who knows these rules.

The fact that MSRB rules apply at all results, of course, from the Exchange Act and not because the MSRB has sought to regulate municipal fund securities. Dealers selling mutual fund IRA accounts and municipal bond mutual funds are not required to comply with MSRB rules because these securities are not municipal securities and are instead subject to regulation under other regulatory schemes. In contrast, municipal fund securities are municipal securities and therefore are subject to MSRB rules and exempt from most other provisions of federal securities laws (such as the Securities Act and the Investment Company Act).

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

Within 35 days of the 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 the 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 is consistent with the Exchange Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submissions, 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 will also be available for inspection and copying at the MSRB's principal offices. All submissions should refer to File No. SR-MSRB-2002-03 and should be submitted by April 24, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02-8041 Filed 4-2-02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45663; File No. SR-NASD-2002-38]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to the Replacement of an Arbitrator Upon Disqualification or Other Disability of an Arbitrator

March 27, 2002.

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 March 13, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), 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 Dispute Resolution. NASD Dispute Resolution amended its proposal on March 22, 2002.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

NASD Dispute Resolution is proposing to amend the procedure followed upon the disqualification or other disability of an arbitrator on a three-person arbitration panel under Rule 10313 of the Code of Arbitration

Procedure ("Code"). Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in brackets.

* * * * *

CODE OF ARBITRATION PROCEDURE

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10313. *Disqualification or Other Disability of Arbitrators*

(a) In the event that any arbitrator, after the commencement of the earlier of [(a)] (1) the first pre-hearing conference or [(b)] (2) the first hearing but prior to the rendition of the award, should become disqualified, resign, die, refuse or otherwise be unable to perform as an arbitrator, [the remaining arbitrator(s)] shall continue with the hearing and determination of the controversy, unless such continuation is objected to by any party within 5 days of notification of the vacancy on the panel. Upon objection,] the Director shall appoint a replacement arbitrator to fill the vacancy and the hearing shall continue. *In the alternative, if all parties agree to proceed with any remaining arbitrator(s), they shall inform the Director in writing within 5 business days of notification of the vacancy, and the remaining arbitrator(s) shall continue with the hearing and determination of the controversy.*

(b) The Director shall inform the parties as soon as possible of the name and employment history of the replacement arbitrator for the past 10 years, as well as information disclosed pursuant to Rule 10312. A party may make further inquiry of the Director concerning the replacement arbitrator's background. If the arbitration proceeding is subject to Rule 10308, the party may exercise his or her right to challenge the replacement arbitrator within the time remaining prior to the next scheduled hearing session by notifying the Director in writing of the name of the arbitrator challenged and the basis for such challenge. If the arbitration proceeding is not subject to Rule 10308, within the time remaining prior to the next scheduled hearing session or the 10 day period provided under Rule 10311, whichever is shorter, a party may exercise the party's right to challenge the replacement arbitrator as provided in Rule 10311.

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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 Dispute Resolution included statements concerning the purpose of

¹² 17 CFR 200.30-3(a)(12).

¹³ 15 U.S.C. 78s(b)(1).

¹⁴ 17 CFR 240.19b-4.

³ See letter from Barbara Z. Sweeney, Senior Vice President, NASD Dispute Resolution, to Florence Harmon, Senior Special Counsel, Division of Market Regulation, Commission, dated March 22, 2002 ("Amendment No. 1"). In Amendment No. 1, NASD Dispute Resolution replaced the original rule filing in its entirety and changed the filing to become immediately effective upon filing pursuant to section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4. 15 U.S.C. 78s(b)(3)(A) and 17 CFR 240.19b-4(f)(6).