and liquidity of the market for such additionally listed securities.

Finally, the Commission notes that the proposed change to the pilot program does not alter the notification requirement to order entry firms, and the effective date of a specialist's deregistration.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication notice thereof in the **Federal Register**. This will permit the changes to be in effect for as much of the pilot program as possible thereby allowing CHX to better assess the effects of these changes to be assessed prior to the expiration of the pilot. In addition, the rule change that implemented the pilot program was published in the **Federal Register** for the full comment period and no comments were received. Accordingly, the Commission believes that it is consistent with Sections 6 and 19(b) of the Act [7] to accelerate approval of the proposed rule change.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[8] that the proposed rule change (SR–CHX–97–29) is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[9]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–31394 Filed 11–28–97; 8:45 am]

BILLING CODE 8010–01–M

[7] 15 U.S.C. 78f and 78s(b)(2).

[8] 15 U.S.C. 78s(b)(2).

[9] 17 CAR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39346; File No. SR–NASD–97–79]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Fees and Hearing Session Deposits for the Arbitration of Claims by Public Investors, Members and Associated Persons

November 21, 1997.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''), 15 U.S.C. 78s(b)(1), notice is hereby given that on October 29, 1997,[1] the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') 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 the self-regulatory organization. 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 Regulation is proposing to amend Rules IM–10104, 10205 and 10332 of the NASD's Code of Arbitration Procedure (''Code'') to increase the arbitrator honoraria and the arbitration filing fees and hearing session deposits for intra-industry and public investor arbitrations administered by NASD Regulation. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

IM–10104. Arbitrator's Honorarium

All persons [serving on panels of arbitrators pursuant to Rule 10104 of] *selected to serve as arbitrators pursuant to* the Association's Code of Arbitration Procedure shall be paid an honorarium for each hearing session *(including a prehearing conference)* in which they participate [while in the performance of said duties].

The honorarium shall be $[150]*200* for [a single] *each hearing* session [, $225 for a double session], $50 for travel to a canceled hearing, and $[50]*75* per day additional honorarium to the chairperson of the panel. The honorarium for a case not requiring a hearing [is $75 per case] *shall be $125.*

10205. Schedule of Fees for Industry and Clearing Controversies

(a) At the time of filing a Claim, Counterclaim, Third Party Claim, or Cross-Claim in an industry or clearing controversy which is required to be submitted to arbitration before the Association as set forth in Rule 10201, above, a party *who is a member* shall pay a non-refundable filing fee and shall remit a hearing session deposit to the Association in the amounts stated in paragraph (k) unless such fee or deposit is specifically waived by the Director of Arbitration. *A party who is an associated person shall pay a non-refundable filing fee and shall pay a hearing session deposit in the amounts specified for customer claimants in Rule 10332. If the associated person is a joint claimant with a member, the member shall pay a non-refundable filing fee and shall pay a hearing session deposit in the amounts specified in paragraph (k) of this Rule.* Where multiple hearing sessions are required, the arbitrator(s) may require any of the parties to make additional hearing deposits for each additional hearing session. In no event shall the amount deposited by all parties per hearing session exceed the amount of the largest initial hearing deposit made by any party under the paragraph (k) below.

(b) No change.

(c) No change.

(d) No change.

(e) If the dispute, claim, or controversy does not involve, disclose, or specify a money claim, the non-refundable filing fee assessed *on a party who is a member* shall be $500. If the dispute, claim, or controversy does not involve, disclose, or specify a money claim, the hearing session deposit to be remitted by a party shall be *$1000* [$600]. These amounts may be adjusted by the Director of Arbitration or the panel of arbitrators may require *the maximum amount specified in the schedule* [$1,000].

(f) No change.

(g) No change.

(h) No change.

(i) If an eligible matter is submitted for arbitration as a large and complex case, under the procedures set forth in Rule 10334, or under procedures agreed upon by the parties, following the Administrative Conference specified in Rule 10334(b), the fees and deposits for such matter shall be those set forth in the schedule of fees for claims over *$10,000,000* [$5,000,000].

(j) No change.

(k) Schedule of Fees

[1] The NASD submitted Amendment No. 1 to the proposed rule filing on November 14, 1997, the substance of which is incorporated into this notice and the proposed rule filing. *See* letter from John M. Ramsay, Deputy General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Market Regulation, Commission, dated November 12, 1997 (''Amendment No. 1'').

SCHEDULE OF FEES

Amount in dispute (exclusive of interest and expenses)	Claim filing fee	Deposit for cases to be decided on the paper record [simplified[1]]	Hearing Session Deposit	
			One arbitrator[1][2]	Three arbitrators[2][3]
$.01–$1,000	$*200* [500]	$*25* [75]	$*25* [300]	NA
$1,000.01–$2,500	*$300* [500]	*$50* [75]	$*50* [300]	NA
$2,500.01–$5,000	$*400* [500]	$*125* [75]	$*125* [300]	NA
$5,000.01–$10,000	$500	$*250* [75]	$*250* [300]	NA
$10,000.01–*$25,000*	*$750*	$*300*	$*450*	*NA*
$*25,000.01*–$30,000	$*1,000* [500]	NA	$*450* [300]	$–600
$30,000.01–$50,000	$*1,000* [500]	NA	$*450* [300]	$–600
$50,000.01–$100,000	$*1,000* [500]	NA	$*450*[3][300[4]]	$*750* [600]
$100,000.01–$500,000	$*1,000* [500]	NA	$*450*[3][300[4]]	$–*1,125* [750]
$500.000.01–*$1,000,000*	*$1,250*	*NA*	$*450*[3]	$*1,200*
$1,000,000.01–$5,000,000	*$2,000* [500]	NA	$*450*[3][300[4]]	$*1,200* [1,000]
[Over]$5,000,000.*01–$10,000.000.00*	*$2,500* [500]	NA	$*450*[3][300[4]]	$*1,200*[1,500]
Over $10,000,000	*$5,000*	*NA*	$*450*[3]	*$1,200*

[1 Simplified Arbitration (Without Hearing)]
[1][2] *The dispute is resolved by o*[O]ne *a*[A]rbitrator *per hearing session, including pre-hearing conferences.* [(Per hearing session)]
[2][3] *The dispute is resolved by t*[T]hree [or more] *a*[A]rbitrators *per hearing session.* [(Per hearing session)]
[3][4] *Fee applies only to p*[P]re-hearing *c*[C]onferences [Only] *with a single arbitrator.*

10332. Schedule of Fees for Customer Disputes

(a) No change.
(b) No change.
(c) No change.
(d) No change.
(e) If the dispute, claim, or controversy does not involve, disclose, or specify a money claim, the non-refundable filing fee for a public customer shall be $250 and the non-refundable filing fee for an industry party shall be $500[.00]. The hearing session deposit to be remitted by a party shall be $*1000* [$600] or such greater or lesser amount as the Director of Arbitration or the panel of arbitrators may require, but shall not exceed *the maximum amount specified in the schedule* [$1,000].
(f) No change.
(g) No change.
(h) If an eligible matter is submitted for arbitration as a large and complex case under the procedures set forth in Rule 10334, or under procedures agreed upon by the parties, following the Administrative Conference specified in Rule 10334(b), the fees and deposits for such matter shall be those set forth in the schedule of fees for claims over *$10,000,000* [$5,000,000].
(i) No change
(j) No change
(k) Schedule of Fees

For purposes of the schedule of fees, the term ''claim'' includes Claims, Counterclaims, Third Party Claims, and Cross-Claims. Any such claim made by a customer *or associated person* is *treated as* a customer claim *for purposes of the schedule of fees.* Any such claim made by a member [or associated person of a member] is an industry claim.

CUSTOMER *or Associated Person* CLAIMANT

Amount in dispute (exclusive of interest and expenses)	Claim filing fee	Deposit for cases to be decided on the paper record [simplified [1]]	Hearing session deposit	
			One arbitrator [1][2]	Three arbitrators [2][3]
$.01–$1,000	*$ 25* [15]	*$ 25* [15]	*$ 25* [15]	NA
$1,000.01–$2,500	$ 25	*$ 50* [25]	*$ 50* [25]	NA
$2,500.01–$5,000	$ 50	$125 [75]	*$125*[100]	NA
$5,000.01–$10,000	$ 75	*$250* [75]	*$250* [200]	NA
$10,000.01–*$25,000*	*$125* [100]	*$300* [NA]	*$450*	*NA*
$25,000.01–$30,000	*$150*	*NA*	*$450*[300]	$ 400
$30,000.01–$50,000	*$175* [120]	NA	*$450*[300]	*$ 600*[400]
$50,000.01–$100,000	*$225* [150]	NA	*$450*[3][300[4]]	*$ 750*[500]
$100,000.01–$500,000	*$300* [200]	NA	*$450*[3][300[4]]	*$1,125*[750]
$500,000.01–*$1,000,000*	*$375* [250]	NA	*$450*[3][300[4]]	*$1,200*[1,000]
$1,000,000.01–$3,000,000	*$500*	*NA*	*$450*[3]	*$1,200*
$3,000,000.01–$5,000,000	*$600*	*NA*	*$450*[3]	*$1,200*
[Over]$5,000,000.01–*$10,000,000*	*$600* [300]	NA	*$450*[3][300[4]]	*$1,200*[1,500]
Over $10,000,000	*$600*	*NA*	*$450*[3]	*$1,200*

[1 Simplified Arbitration (Without Hearing)].
[1][2] *The dispute is resolved by o*[O]ne *a*[A]rbitrator *per hearing session, including pre-hearing conferences.* [(Per Hearing Session)].
[2][3] *The dispute is resolved by t*[T]hree [or more] *a*[A]rbitrators *per hearing session.* [(Per hearing session)].
[3][4] *Fee applies only to p*[P]re-hearing *c*[C]onferences [Only] *with a single arbitrator.*

MEMBER [INDUSTRY] CLAIMANT

Amount in dispute (exclusive of interest and expenses) arbitrators [2] [3]	Claim filing fee	Deposit for cases to be decided on the paper record [simplified [1]]	Hearing Session Deposit	
			One	Three arbitrator [1] [2]
$.01–$1,000	$*200* [500]	$*25* [75]	$*25* [300]	NA
$1,000.01–$2,500	$*300* [500]	$*50* [75]	$*50* [300]	NA
$2,500.01–$5,000	$*400* [500]	$*125* [75]	$*125* [300]	NA
$5,000.01–$10,000	$500	$*250* [75]	$*250* [300]	NA
$10,000.01–*$25,000*	*$750*	*$300*	*$450*	*NA*
$*25,000.01*–$30,000	*$1,000* [500]	NA	*$450* [300]	$600
$30,000.01–$50,000	*$1,000* [500]	NA	*$450* [300]	$600
$50,000.01–$100,000	*$1,000* [500]	NA	*$450* [3][300 [4]]	*$750* [600]
$100,000.01–$500,000	*$1,000* [500]	*NA*	*$450* [3][300 [4]]	*$1,125* [750]
$500,000.01–$*1,000,000*	*$1,250*	NA	*$450* [3]	*$1,200*
$*1,000,000.01*–$5,000,000	*$2,000* [500]	NA	*$450* [3][300 [4]]	*$1,200* [1,000]
[Over] $5,000,000.*01–$10,000,000*	*$2,500* [500]	NA	*$450* [300 [4]]	*$1,200* [1,500]
Over $10,000,000	*$5,000*	*NA*	*$450* [3]	*$1,200*

[1 Simplified Arbitration (Without Hearing)]
[1] [2] *The dispute is resolved by o*[O]ne *a*[A]rbitrator *per hearing session, including pre-hearing conferences.* [(Per Hearing Session)]
[2] [3] *The dispute is resolved by t*[T]hree [or more] *a*[Arbitrators *per hearing session.* [(Per hearing session)]
[3] [4] *Fee applies only to p*[P]re-hearing *c*[C]onferences [Only] *with a single arbitrator.*

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 self-regulatory organization 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 self-regulatory organization 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 and Introduction

NASD Regulation is proposing to amend the NASD's Code of Arbitration Procedure to increase the filing fees and hearing session deposits charged to public investors, member firms and associated persons for arbitrating disputes under the Code. In addition, NASD Regulation is proposing to increase the honoraria paid to arbitrators.[2]

In support of the proposed rule change, below is a discussion of NASD Regulation's arbitration program operating costs and revenue, new initiatives for improving the arbitration program, and a general description of filing fees, hearing session deposits and forum fees charged in arbitration proceedings. In addition, the development of the proposed fee increases is described. Finally, a narrative description of the proposed rule change is provided.

Operating Costs and Revenue. NASD Regulation's Office of Dispute Resolution (''Office''), and its predecessors, have been administering arbitrations for the Association since 1969. Since 1972 NASD Members have been required to submit disputes to arbitration upon the request of a customer, another member or an associated person. Submission of claims to arbitration by public investors was largely voluntary until 1987 and, as a result, the program handled a relatively small number of cases each year. Following the United States Supreme Court's 1987 decision in *Shearson/American Express, Inc. v. McMahon,* 482 U.S. 220, 96 L.Ed.2d 185, 107 S.Ct. 2332, affirming the enforceability of customer predispute arbitration agreements, the arbitration caseload grew rapidly and the program now handles more than 6,000 cases annually.

The Office's operating costs have been funded from filing fees (charged to any party filing a claim in arbitration), forum fees (charged for each hearing session held in an arbitration and allocated by the arbitrators in the award to the parties), and, more recently, member surcharges (charged to any member named in a claim and to any member when an employee of the member is named in a claim). The difference between the revenue collected in fees and the cost of administering the program has been made up from the general member assessment revenue collected by the Association from all of its members. As the number of cases has grown, and the cost and complexity of administering arbitration proceedings have increased, NASD Regulation has sought to increase the fees in order to shift the costs of the program primarily to its member users. In 1994, for example, NASD Regulation began charging members a non-refundable fee if the member or an associated person of the member was named in an arbitration proceeding—the ''member surcharge.''

In spite of the effort to shift the costs to service users, the Office is not collecting sufficient user revenue to cover its costs. For example, as the table below illustrates, in 1996 the cost of the dispute resolution program exceeded fee

[2] This rule filing replaces SR–NASD–97–39, in which NASD Regulation originally proposed the amendments to the filing fees and hearing session deposits that are contained in this filing. As discussed below, in this filing NASD Regulation has modified some of the fee changes proposed in SR–NASD–97–39 to align the fees charged more closely with the Office of Dispute Resolution's (''Office'') average costs of administering arbitration proceedings. In addition, the budget, revenue and cost figures used throughout this filing reflect the most current information about the arbitration process.

Since SR–NASD–97–39 was filed, the NASD has completed its 1998 budget process. The Office's revised 1998 revenue and expense figures from the 1998 Budget (set forth in Table 1) reflect significant savings resulting from the NASD's ''Reinvesting for Our Future'' program. This program required NASD departments to identify areas within their operations where savings could be achieved. In addition, the Office's 1997 revenue and cost experience through the end of September 1997, and including the new member surcharges implemented on July 1, 1997, caused NASD Regulation to revise the Office's projected 1998 revenues and costs. The revised revenue and cost projections are reflected in this rule filing.

revenue by $11.3 million. For 1997, even with the implementation of substantial increases in the member surcharge and an increase in revenue due to increases in the arbitration caseload, the cost will exceed revenue by $16 million. For 1998, even if the proposed changes are approved and implemented, the cost of the program will exceed revenue by $6.1 million.

TABLE 1.—REVENUES VS. EXPENSES

[In thousands of dollars]

	1995 Actual	1996 Actual	1997 Projected (with member surcharge increase effective 7/1/97)	1998 Projected (includes member surcharge and arbitrator honorarium increase, but without fee increase)	1998 Projected (with member surcharge, arbitrator honorarium increase and fee increases)
Revenue	$9,664	$13,275	$16,000	$23,110	$29,100
Expenses	$17,826	$24,617	$31,988	$35,128	$35,158
Net	($8,162)	($11,342)	($15,988)	($12,058)	($6,058)

The revenue shortfall in the program is currently made up from general assessment revenue; however, NASD Regulation is developing further increases in the member-user fees to close the budget gap. There will not be any further increases in fees charged to public investors in the foreseeable future.

New Initiatives to Improve the Arbitration Program. In January 1996, the NASD's Arbitration Policy Task Force (''Task Force'') released its report on Securities Arbitration Reform. The Task Force's report made numerous recommendations to improve the arbitration process. Some of the recommendations, such as early appointment of arbitrators, have been implemented. Other recommendations, such as selecting arbitrators by a list selection method, involve significant technological changes and changes in the way the Office administers arbitration cases. And still others, like increasing arbitrator honoraria to attract and retain qualified arbitrators, involve permanent increases in the NASD's costs of operating the program.

Since the report was released, NASD Regulation has been engaged in a major effort to implement the numerous Task Force recommendations. The Office also has other initiatives underway to improve the arbitrator process. These include improving case processing and administration by, among other things, upgrading the computerized case tracking system and hiring additional staff. Some of the changes, such as increasing arbitrator honoraria and implementing list selection of arbitrators, will result in permanent increases in the cost to the NASD of administering the dispute resolution program, while others, such as improving case tracking, should result in savings. Implementing these changes will substantially improve the fairness and efficiency of the arbitration process. Finally, the growth rate in NASD Regulation's arbitration case load over the last ten years, and the increasing length and complexity of arbitration cases, are generating additional cost pressures on the Office in its continuing efforts to meet the needs of users of the dispute resolution services.[3]

The amendments to the fee schedules proposed in this rule change will serve to close some of the user revenue gap that currently exists in funding the Office's direct costs of providing arbitration services. However, the revenue from the proposed fee increases on public investors will not be used to fund the development of new systems or the implementation of the Task Force's recommendations. The exception to this is the early appointment of arbitrators, a Task Force recommendation that has already been implemented, and the proposed increases in arbitrator honoraria, which will be an increase in the Office's direct cost of administering arbitrations. Both of these initiatives directly benefit public investors, the first by improving the efficiency of arbitration, the second by attracting and retaining a higher caliber of willing, committed arbitrators.

General Description of Filing Fees, Hearing Session Deposits and Forum Fees. The fees and deposits for arbitration proceedings fall into three categories: (1) filing fees (including member surcharges);[4] (2) hearing session deposits; and (3) forum fees.

Filing fees are submitted by the party filing a claim. Filing fees are required for all claims, including cross-claims, counterclaims and third party claims. For example, if a public investor files a claim against two members, the investor pays a filing fee specified in Rule 10332 for public investor claimants based on the aggregate amount claimed. If one member then files a counterclaim against the public investor, the member pays the filing fee specified in Rule 10332 for industry claimants based on the aggregate amount claimed in the counterclaim. If the member then files a cross-claim against the other member firm respondent or a third party claim against another member, the member pays another filing fee as specified in Rule 10332 for industry claimants based on the aggregate amount claimed in the cross-claim and the member who is a third party respondent pays a member surcharge based on the aggregate amount claimed in the third party claim. The members each pay one member surcharge when they are brought into the case, whether through a claim, counter-claim, cross-claim or third party claim.

A hearing session deposit is required for arbitrations where hearings will be held and is intended as an advance payment for the Office's cost of conducting one hearing session. If the arbitrators determine that several

[3] The number of cases filed with NASD Regulation's Office of Dispute Resolution in the first five months of 1997 is up 16 percent over the same period in 1996. The number of cases filed annually has risen from 2,886 in 1987 to an estimated 6,247 in 1997 based on the number of cases filed in the first nine months of 1997, a 116 percent increase. NASD Regulation projects that over 6,900 cases will be filed in 1998, an increase of 139 percent over 1987.

[4] Member surcharges imposed pursuant to Rule 10333, are intended to shift some of the costs of the dispute resolution program to the members who are actually named in cases and, therefore, are the primary users of the program.

hearing sessions may be necessary, Rule 10332(a) permits them to order the parties to make additional hearing session deposits. The cost of conducting a hearing session includes arbitrator compensation and travel expenses, hearing conference rooms, and staff work and expenses. All parties are required to pay the hearing session deposits specified in Rules 10205 and 10332. Any member firm filing a cross-claim, counterclaim, or third party claim against a public investor must pay the hearing session deposits specified for industry claimants in Rule 10332. In addition, if a case is settled or withdrawn more than eight days before a hearing is held, the hearing session deposit is refunded; in the Office's experience this occurs two-thirds of the time.

Forum fees are NASD Regulation's charges that are assessed by the arbitrators to the parties for conducting hearings where evidence and testimony is presented. The fees are based on the number of hearing sessions scheduled and conducted. Thus, forum fees can be assessed even if there is no final award. Forum fees assessed by the arbitrators are paid to NASD Regulation, not to the arbitrators, and the arbitrators' compensation is not affected by the amount of forum fees assessed or collected. The arbitrators can assess forum fees for each hearing session up to the maximum hearing session deposit that the party is required to pay under Rule 10332. For example, under the proposed rule change, the hearing session deposit for a public investor with a $100,000 claim is $750. Therefore, if an arbitration took four hearing sessions (two full days), the arbitrators could assess a maximum of $3,000 in forum fees.[5] The arbitrators can assess the forum fees evenly between the parties, or apportion the fees in any other manner, including assessing all forum fees against one party. The arbitrators can also determine to assess only part of the forum fees against one party (the respondent, for example) and not assess any forum fees against another party (the claimant, for example). Any forum fee assessed against any party is reduced by the amount of hearing session deposits already paid by the party.

Development of Proposed Fee Increases

As a result of the continuing growth of the program and the current and projected operating revenue shortfalls, NASD Regulation determined that changes to the funding mechanisms were necessary. Moreover, as discussed below, the fees collected under the current schedule do not come close to covering the NASD's costs of providing the arbitration service. In order to ensure that the changes were appropriate to the goals of the program and fair to its users, NASD Regulations established guidelines for fee increases and analyzed the program to identify the cost of each service.[6] In addition, NASD Regulation identified the member users of the program.

In 1996, case volume for the entire program (public investor and intra-industry arbitration) was analyzed to obtain a profile of the users of arbitration services and to project the impact of future fee changes upon member firms.[7] This analysis revealed that only 753 firms (14 percent) out of approximately 5,500 NASD member firms had been parties to arbitration cases. Of these 753 firms, 88 firms (12 percent) accounted for over 50 percent of the case volume. Each of these 88 firms reported revenues in excess of $100 million on their FOCUS filings.[8] In contrast, firms that reported revenues of less than $500,000 accounted for only 9 percent of NASD member firms and less than 3 percent of the total projected case load. Thus, a small number of large firms are involved in more than 50 percent of all arbitration cases. NASD Regulation considers these firms to be the primary and most frequent member users of the service and, therefore, believes it is appropriate for any fee changes to shift member costs to these member users. The proposed rule changes, including the changes to the member surcharge adopted in July 1997, largely accomplish this goal. In addition, any future changes to the fee structure will transfer any additional costs to these primary users of the program.

The Office has analyzed the overall flow of revenue from users of the arbitration services for the twelve months ending August 31, 1997. After calculating filing and other fees with forum fees actually paid by public investors and refunds received by public investors, the data show that public investors currently are assessed approximately $3.5 million of $15.3 million in fee revenue collected from users. This is 23 percent of the total fee revenue. Although the time periods are not directly comparable, the revenue contribution of public investors over the twelve months ended August 31, 1997 is less than 12 percent of the $29.8 million calendar year 1997 projected total cost of running the dispute resolution program. Public investors, however, file approximately 80 percent of the new claims filed with the Office each year. Moreover, even though some of these revenue contribution figures will vary because of differences in case volume, forum fee allocations and other factors, NASD Regulation believes that the total relative revenue contributions of public investors and members will not change substantially after the proposed fee changes are approved.

Overall, NASD Regulation expects that the fee changes proposed in this rule filing and the member surcharge changes implemented earlier in 1997 will generate approximately $11.5 million in additional revenue. The combination of increases in fees (filing fees, member surcharges and hearing session deposits) charged to members will generate $8.4 million in additional revenues (73 percent of total additional revenues to be generated by the fee changes). Even with this additional revenue, the Office will continue to incur operating shortfalls of more than $6.1 million.

Guidelines for Proposed Fee Increases. In developing the proposed rule change, NASD Regulation identified several important principles to guide its decisions on the appropriate fees for the arbitration service it provides:

- The current ratio of public investor fees to member fees should not change. Currently public investors pay approximately 23 percent of the

[5] Arbitrators assess forum fees in the award. The Office keeps track of the number of hearing sessions held, the hearing session charge to be applied and any other fees paid or incurred (such as filing or postponement fees and hearing session deposits) and advises the arbitrators. The arbitrators then determine how much of the fees, if any, each party will be responsible for paying, sometimes setting forth liability for the fees in percentages and specifying individual or joint and several liability for the fees. Finally, the award will set forth the specific amounts of fees owed by each party.

[6] The NASD Regulation Board of Directors formed a Subcommittee on Arbitration Fees to examine the current revenue, cost and fee structure, and to recommend changes. The Subcommittee was composed of three public members (James E. Burton, CalPERS; Bonnie Guiton Hill, Times-Mirror Corp.; and William S. Lapp, Esq., Lapp, Laurie, Libra, Abramson & Thomson, board member of the Public Investors Arbitration Bar Association and member of NASD Regulation's National Arbitration and Mediation Committee (NAMC)) and three securities industry members (Raymond E. Wooldridge, Southwest Securities Group, Inc., NAMC member and Chairman of NAMC's Finance Subcommittee, and former Vice-Chairman of NASD Regulation's Board of Directors; Philip S. Cottone, Rutherford, Brown & Catherwood, Inc., Chairman of NAMC and former member of NASD Regulation's Board of Directors; and O. Ray Vass, Merrill, Lynch, Pierce, Fenner & Smith, Inc., member of NASD Regulation's Membership Committee).

[7] *See* Table 3, *infra*, for a summary of the analysis.

[8] FOCUS Reports (Financial and Operational Combined Uniform Single Reports) are submitted to the NASD pursuant to SEC Rule 17a–5 by member firms to report on the member's net capital and general financial position.

arbitration service fees and members pay 77 percent.

• The fees should not create a financial barrier to prevent a public investor from seeking arbitration. The maximum fee charged to public investors should not exceed the direct costs of providing the service and public investors should be permitted to ask the Office to waive the fees in circumstances of financial hardship.

• The fees for a public investor to file a case in arbitration (the filing fee plus hearing session deposit) must be less or no more than the initial fee charged to the member named in the aribration (the member surcharge).

• The revenue contribution plan should, to the extent possible, impose costs on the member firms that use the program.

• Any fee increases for public investors should be allocated to reduce the revenue shortfall for direct arbitration services alone. Additional fee increases to cover revenue shortfalls for other dispute resolution programs and indirect operating costs would be assessed to member users of the dispute resolution programs.

Activity-Based Cost Analysis. In order to understand better the costs of administering the dispute resolution program, NASD Regulation, assisted by the accounting firm of Coopers & Lybrand, conducted an activity-based costing study to identify more accurately the Office's current costs and link specific activity costs to the services provided. This study identified fifty-two separate arbitration service activities and determined the total direct cost of performing each activity.

In addition to providing the Office with a better understanding of particular activities and costs, the study also provided a program-wide perspective of the raw average costs and average fees collected in both simplified and standard arbitration cases. The study showed, on a per occurrence basis, the costs associated with activities such as: (1) receiving and processing claims; (2) analyzing and serving claims; (3) selecting arbitrators; (4) scheduling hearings; and (5) conducting hearing sessions. The analysis has permitted the Office to extrapolate its likely costs for 1998 and compare them to the revenue expected. This ''Break-Even Analysis'' is attached to this filing as Exhibit 2 and is discussed below.

The raw average costs for particular activities have been identified by breaking down the work of the Office into discrete functions, such as ''Receiving Claims.'' The cost of performing these discrete functions is then identified by totaling the staff hours and other expenses devoted to the function. The number of occurrences of the function are then identified and counted. The number of times the receiving claims function occurs matches the number of claims filed with the Office each year. The number of occurrences of the function is then divided into the total cost to derive the per occurrence cost of the function, or the raw average cost. The average cost of each function can be multiplied by the number of times it occurs in each case and added to all of the other functional costs of a case to produce the average cost of a hypothetical case.

The costs associated with particular cases, however, fall along a wide spectrum depending on the nature of the case. Cases that are settled shortly after being filed usually cost little to administer. Cases that involve numerous and complex issues, numerous pre-hearing rulings and conferences with the arbitrators, lengthy hearings and, finally, an award are more costly to administer than other cases. The Office has also found that the larger the amount in dispute, the more costly the case is to administer because there are usually more parties involved (which makes communication more costly and time consuming), there are more motions and other disputes to resolve, and prehearing conference and hearing logistics are more complicated. This wide spectrum of costs is the reason that the Office imposes graduated fees in two stages: filing fees and forum fees (the latter are partly prepaid through hearing session deposits).

Finally, NASD Regulation notes that the activity-based cost analysis is a useful analytical tool for budgeting and planning; however, it should not be relied upon to produce guaranteed cost figures. The actual costs of providing the services can and will vary due to factors that are unpredictable and beyond NASD Regulation's ability to control.

Proposed Rule Changes

In view of the foregoing, NASD Regulation is proposing to amend the schedules of fees (including hearing session deposits) for both intra-industry and public investor disputes to support the improvement of the arbitration service administered by the Office and to shift the cost of administering the service to the users.

The filing fee and hearing session deposit changes proposed in this rule filing are discussed in four separate categories: (1) filing fees for claims by public investors against members (''Public Investor-Member Disputes''); (2) filing fees for claims by members against public customers (''Member-Public Investor Disputes'') or other members or associated persons (''Intra-industry Disputes''); [9] (3) hearing session deposits in all cases between public investors and members, and in intra-industry cases; and, (4) miscellaneous changes. Also discussed are NASD Regulation's proposed changes to the arbitrator honorarium schedule. NASD Regulation believes the changes, taken together, will maintain the current ratio of funding of the arbitration service between public investors and members.[10]

Filing Fees: Public Investor-Member Disputes. NASD Regulation is proposing to amend Rule 10332 to increase the filing fee for disputes between a public investor claimant and a member respondent by an average of 50 percent in most brackets (fees are based on the amount in dispute, and a range of amounts in dispute (e.g., $50,000.01 to $100,000) to which a particular fee applies is referred to as a bracket) and add three new brackets to graduate further the fee schedule. For example, the old bracket of fees for claims of $10,000.01 to $30,000 has been divided into two brackets; one from $10,000.01 to $25,000 with a new filing fee of $125 (versus $100 for the old bracket), and another from $25,000.01 to $30,000 with a new filing fee of $150. The old bracket was divided to take into account the new ceiling for simplified arbitration cases, which was raised from $10,000 to $25,000.[11] The largest filing fee increases are for the largest cases; the filing fee for claims of more than $10,000,000 is being raised 100 percent from $300 to $600.[12]

Using the costs identified in the activity-based costing study, NASD Regulation believes that in 1998 the average direct cost associated with processing a simplified arbitration case

[9] The proposed rule change treats associated persons of members like public customers for purposes of fees. *See* discussion, *infra.*

[10] For the twelve month period ending August 31, 1997, the net revenue contribution of public investors was approximately $3.5 million. (Net revenue contribution is calculated by identifying the fees paid, including hearing session deposits and postponement fees, less the refunds and reallocations through assessment of costs, such as forum fees.) The net revenue contribution of members was $11.8 million. NASD Regulation is projecting that the combined additional revenue generated by the proposed fee increases in this rule filing and the increased member surcharge already in effect will be approximately $11.6 million. While it is not possible to predict accurately the 1998 net revenue contributions of public investors and members, NASD Regulation intends for the proposed increases to maintain the same ratio of public investor/member net revenue contributions.

[11] *See* note 1, *supra.*

[12] *See* Table 2, *infra.*

from beginning to end will be approximately $412. For a standard case the cost from filing through all activities up to the prehearing conference will range from $353 through at least $630. The activity categories used to calculate average claim processing costs were: (i) receipt/assignment of cases; (ii) check processing; (iii) analyzing claims; (iv) serving claims; (v) processing answers; (vi) processing motions; (vii) processing counterclaims; and (viii) conducting discovery (except for prehearing conferences to resolve discovery issues). Activity costs that were not included, among others, were; (i) recruiting and training of arbitrators; (ii) qualifying arbitrators; (iii) mediation; and (iv) NASD corporate oversight and transfer pricing of services from other departments.

For a simplified arbitration case the proposed customer filing fee for a $10,000 claim is $75, plus a proposed $250 simplified arbitration fee, for a total of $325, versus average costs for simplified cases of $412. Because there are no hearings in such cases, much of the Office's cost is associated with activities from processing the claim up through presenting it to the arbitrator for a decision. By contrast, in cases where hearings are conducted, the hearings constitute by far the largest portion of the cost.

NASD Regulation is proposing filing fees designed to cover as much of the actual costs of the arbitration process from filing up to the prehearing conference as is possible without erecting barriers to entry into arbitration. For a standard case in which more than $100,000 is in dispute and three arbitrators are appointed, the proposed customer filing fee is $300, while the Office's average expenses for administering the case from filing up to the pre-hearing conference will be at least $477. The margins for large bracket cases are smaller, but the proposed fees do not exceed the actual average cost to provide the service.

NASD Regulation's ''Break-even Analysis'' (attached as Exhibit 2) illustrates how the Office's costs of administering an arbitration correlate to the revenues obtained through filing fees and hearing session deposits using 1998 figures and the proposed fee increases.[13] The analysis uses the activity categories identified in the activity-based costing study. For each type of activity the Office's total cost of performing the activity (serving claims, for example) is divided by the number of times the particular activity occurs to produce an approximate average cost for each occurrence of the activity. These activities and their costs are then charted sequentially as they would likely occur in a case to produce a hypothetical cumulative cost at each major stage of a case. This average cost is charted against the fee revenue received in a case. As noted above, however, NASD Regulation does not regard the analysis as a guarantee that in each case each step in the process will cost no more than the average predicted by the analysis.

The analysis shows that well before a preheating conference is held the claim filing fee revenue has been used up and, after an award is rendered following a hearing, all of the fee filing revenue and forum fees that could be collected in a case have been expended. The analysis takes into account that some activities (processing motions, for example) will occur several times in a case. In addition, the costs of some activities (notably, holding hearings) vary greatly so that, although it is possible to establish an average cost for the activity, the cost of the activity in a particular case could be substantially higher or lower than the average. Finally, in the Office's experience, the cost of some activities tends to vary by the amount in dispute, with larger cases tending to cost more to administer at certain stages than smaller cases. The Office believes that the cost variance may result from the increased contentiousness of the litigants when there are significant damages in dispute and there are sometimes larger numbers of parties involved in cases where large amounts are in dispute.

While the proposed increases in filing fees and hearing session deposits are expected to generate $3.1 million in additional revenue from public investors, the increase will be spread over more than 5,000 cases and should not discourage claimants from seeking relief. For example, in cases where more than $50,000 is in dispute (approximately 16 percent of the public investor cases filed with the Office), the filing fee is increasing $75 from $150 to $225. The increase of $75 represents less than 2/10 of 1 percent of the amount in dispute.[14] The filing fee increases in other brackets are similarly small relative to the amount in dispute:

[13] Exhibit 2 to the proposed rule filing presents examples of how the proposed filing fees and forum fees would apply in particular types of cases and the Office's average costs of administering arbitration proceedings in such cases. The figures in the line ''Net of revenues—cost'' show the loss the Office will incur in the example when the Office's costs are subtracted from the revenues collected. Similarly, the final figure in each example shows how much the Office would lose in such cases after the Office's total costs are subtracted from the revenues collected, including forum fees. In addition, for comparison purposes, Exhibit 2 includes the current forum fees that would be charged for the type of case in each example. Because the cost figures set forth in Exhibit 2 are averages, parties should not regard them as predictive of the actual cost of administering their case.

[14] By contrast, the filing fees of the American Arbitration Association (''AAA'') range from $300 to $4,000, depending on the amount in dispute. In addition, the AAA's rules require the parties to pay arbitrator honorariums and other costs of an arbitration proceeding.

TABLE 2.—PERCENTAGE INCREASE IN CUSTOMER FILING FEES

	Old filing fee	Proposed new filing fee	Dollar amount of increase	Percent increase	Increase as percent of amount in dispute
$.01–1,000.00	$15	$25	$10	66.67	1.000
$1,000.01–2,500	25	25	0	0.00	0.000
$2,500.01–5,000	50	50	0.000	0	0.000
$5,000.01–10,000	75	75	0	0.00	0.000
$10,000.01–25,000	100	125	25	25.00	0.250
$25,000.01–30,000	100	150	50	50.00	0.200
$30,000.01–50,000	120	175	55	45.83	0.183
$50,000.01–100,000	150	225	75	50.00	0.150
$100,000.01–500,000	200	300	100	50.00	0.100
$1,000,000.01–3,000,000	250	500	250	100.00	0.025
$500,000.01–3,000,000	250	375	125	50.00	0.025
$3,000.01–5,000,000	250	600	350	140.00	0.012
$5,000.01–10,000,000	300	600	300	100.00	0.005
Over $10,000.000	300	600	300	100.00	0.005

Filing Fees: Member-Public Investor Disputes and Intra-Industry Disputes. NASD Regulation also is proposing to amend Rule 10332 to increase the filing fees where a member files a claim against a public investor. The current filing fee is $500 for all brackets. NASD Regulation is proposing to substitute a graduated filing fee beginning at $200 for claims of $1,000 or less up to $5,000 for claims over $10,000,000. By graduating the fee schedule, the filing fees are assessed proportionately on the members based on the size of the claim. Thus, while the filing fees for large claims would increase substantially, the filing fees for small claims would actually decrease. The fairness of the fee schedule to members with small claims is enhanced by decreasing fees for claims of $5,000 or less.

NASD Regulation also is proposing to amend Rule 10205 to increase and graduate the filing fees for intra-industry disputes. Currently, the filing fees are $500 regardless of the amount in dispute. NASD Regulation is proposing to graduate the filing fee from $200 for claims of $1,000 or less up to $5,000 for claims exceeding $10,000,000 in order to make the filing fee fairer to claimants with small claims.

As noted above, in addition to the filing fee and hearing session deposit increases proposed in this rule filing, NASD Regulation has increased substantially the surcharge on members named as respondents in an arbitration proceeding.[15] Taken together, the surcharges and proposed fee increases on members in both public-investor and intra-industry cases are expected to generate $8.4 million in additional revenue, or 73 percent of the total revenue generated. The specific impact on members is shown below:

Table 3.—Impact of Fee Increases (Including Surcharges) on Member Firms

Capitalization of firm	Number of firms	Number of cases (est. 1998)	Percent of total	Estimated impact (1998)	Impact per firm
$1 Billion +	19	2495	36.18	$3,000,000	$157,895
$100 Million–$1 Billion	69	1062	15.40	1,300,000	18,841
$50 Million–$100 Million	48	531	7.70	650,000	13,542
$25 Million–$50 Million	83	751	10.90	900,000	10,843
$10 Million–$25 Million	117	766	11.11	950,000	8,120
$1 Million–$5 Million	303	1069	15.50	1,300,000	4,290
$500,000–$1 Million	49	111	1.61	150,000	3,061
Less Than $500,000	65	111	1.61	150,000	2,308
Total	753	6896	100.00	8,400,000	11,155

The average increase in cost to member firms for each case will be $1,218.

NASD Regulation is proposing increases in member-user contributions to the dispute resolution process because member firms have indicated that arbitration is their preferred forum for resolving public investor-member disputes through the predispute arbitration agreements that are typical of broker-customer business relationships. Accordingly, the proposed fee increases assess the costs on the actual users of the program.

Hearing Session Deposits. NASD Regulation also is proposing to amend Rules 10205 and 10332 to increase the hearing session deposits[16] for all cases by no more than 50 percent in most brackets (in the lowest brackets increases from $15 to $25, and $25 to $50, represent 67 and 100 percent

[15] Rule filing SR–NASD–97–40, filed for immediate effectiveness on June 12, 1997, and effective July 1, 1997, steeply graduated and increased the surcharge on members from a maximum of $500 under the old schedule to $3,600 under the new schedule.

[16] Hearing session deposits are required before NASD Regulation will schedule a hearing unless waived by the Director due to financial hardship. The amount deposited is offset against the actual hearing costs incurred. If a case is settled, dismissed, or withdrawn more than eight business days before a hearing was scheduled to occur, the hearing session deposit is refunded.

increases, respectively) and to add three new brackets to graduate further the hearing session deposit schedule. For example, the old bracket of fees for claims of $10,000.01 to $30,000 has been divided into two brackets, one from $10,000.01 to $25,000 with a new hearing session deposit of $450 [17] (compared to $300 for the old bracket) for a single arbitrator, and another from $25,000.01 to $30,000 with a new hearing session deposit of $450. In the $25,000.01 to $30,000 bracket the hearing session deposit for three arbitrators will be $600 (compared to $300 for the old bracket). The hearing session deposit for claims of $5,000,000.01 or more is being reduced to $1,200.

The proposed new hearing session deposits are based on the results of the activity-based costing study which showed that, for cases requiring hearings, NASD Regulation's projected average cost to provide hearings in 1998 will be approximately $1,200 per hearing session. The activities used in computing this cost include arbitrator expenses and compensation, hearing room expenses, taping expenses, and staff work and expenses. The Office's experience also shows, however, that the costs of conducting hearings varies significantly with the amount in dispute and the number of parties involved. This is because staff attorneys may need to attend some or all of the hearing sessions, staff coordination of logistics may be more difficult and complicated, and staff communication with the parties may be more involved and time-consuming. Moreover, the hearing session deposits have been graduated from a relatively low level for cases in lower brackets up to the actual average cost of conducting hearings because NASD Regulation believes that charging claimants the full cost of conducting hearings in relatively small cases could discourage some public investors from seeking relief.

In addition, the proposed rule change makes the hearing session deposits for particular brackets the same among all types of cases; public investor vs. member, member vs. public investor and intra-industry. This is being done because NASD Regulation believes the hearing session deposit, and by extension the forum fees, should not exceed the Office's actual costs, and such costs are, on average, approximately the same for all types of cases, even if they may vary by the amount in dispute or the number of parties involved. As a result of this change, the hearing session deposit will be the same without regard to whether a public investor or a member filed the initial claim.

Miscellaneous Changes. NASD Regulation is proposing to amend Rule 10205(a) to provide that if the claimant is an associated person, he or she will pay the filing fee and hearing session deposit specified for public customers. However, if the associated person is a joint claimant with a member, the member will pay the filing fee and hearing session deposit specified for industry claimants. NASD regulation is also proposing to amend Rules 10205(e) and 10332(e) to increase the hearing session deposit from $600 to $1000, or an amount specified by the Director or the arbitrators not exceeding the maximum hearing session deposit specified in the rules, for claims where the amount in dispute is not disclosed by the claimant in the Statement of Claim.[18]

Finally, Rules 10205(i) and 10332(h) are proposed to be amended to provide that the filing fees and hearing session deposits for large and complex cases brought under Rule 10334 [19] will be those specified for cases exceeding $10,000,000. There are a few significant and distinct costs associated with such cases, including the Administrative Conference, the number of hearing sessions, pre-hearing issues to be resolved and customized arbitration procedures that may be requested by the parties.

Arbitrator Honoraria. NASD Regulation is proposing to amend IM–10104 to increase the honoraria paid to arbitrators. The honorarium will be increased from $150 to $200 for each hearing session, with an additional $75 per day for the chairman of the panel. Thus, the Office's honorarium cost for a panel of three arbitrators for one hearing session is $675. The honorarium for a prehearing conference will be $200. The honorarium for a case not requiring a hearing will be $125.

2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act [20] in that the proposed rule change provides for the equitable allocation of reasonable charges among members and other persons using the Association's arbitration facility because it further graduates the fee schedules and requires users, especially member firm users, to absorb a reasonable share of the costs of operating the arbitration program.

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

The NASD does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or received.

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. 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 at

[17] Under the new ceilings for single arbitrator claims without a hearing, claims up to $25,000 may be resolved by a single arbitrator on the pleadings alone. In such cases, a hearing session deposit is not required. Thus, the new $450 hearing session deposit for such cases only applies in the event the claimant requests a hearing.

[18] In cases where the claimant is seeking a remedy other than damages (recision, for example) and does not specify damages, the staff will attempt to establish the market value of the securities which are the subject matter of the claim before resorting to the default fee specified in paragraph (e) of the two rules.

[19] Rule 10334 (the rule for large and complex cases) has been extended for five years and the use of the procedures is now entirely voluntary. *See* Securities Exchange Act Release No. 39024 (September 5, 1997), 62 FR 47856 (September 11, 1997).

[20] 15 U.S.C. 78*o*–3.

the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR–NASD–97–79 and should be submitted by December 22, 1997.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc 97–31392 Filed 11–28–97; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39349; File No. SR–NASD–97–96]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the National Association of Securities Dealers, Inc. To Amend Its Rule 3230 Relating to Clearing Agreements

November 21, 1997.

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 October 14, 1997, the NASD Regulation, Inc. (''NASD Regulation'') 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 Regulation. On November 20, 1997, the NASD Regulation filed Amendment No. 1 to the proposed rule change.[3] 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 Letter from John M. Ramsay, Deputy General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated November 19, 1997 (''Amendment No. 1''). In Amendment No. 1, the NASD Regulation amended the proposal to: (1) Add a sentence to the rule relating to the responsibility of introducing members to notify clearing members of the specific reports needed by the introducing members to supervise its business; (2) clarify that failure to provide such notification would violate not only the proposed rule but also, the Association's supervisory rules; and (3) delete a series of questions directed to readers of the proposal. Commission staff has incorporated the changes set forth in Amendment No. 1 into the notice.

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

NASD Regulation proposes to amend the National Association of Securities Dealers, Inc.'s (''NASD'' or ''Association'') Rule 3230 to: (1) establish standards for the disposition of written customer complaints received by clearing firms about introducing member firms relating to their functions and responsibilities under the clearing agreement; (2) govern how exception reports are made available to introducing firms and retained by clearing firms; and (3) permit introducing firms to write checks on their clearing firm's account. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

3230. Clearing Agreements

(a) All clearing or carrying agreements entered into by a member, except where any party to the agreement is also subject to a comparable rule of a national securities exchange, shall specify the respective functions and responsibilities of each party to the agreement and shall, at a minimum, specify the responsibility of each party with respect to each of the following matters:

(1) Opening, approving and monitoring customer accounts;

(2) Extension of credit;

(3) Maintenance of books and records;

(4) Receipt and delivery of funds and securities;

(5) Safeguarding of funds and securities;

(6) Confirmations and statements;

(7) Acceptance of orders and execution of transactions;

(8) Whether, for purposes of the Commissioner's financial responsibility rules adopted under the Act, and the Securities Investor Protection Act, as amended, and regulations adopted thereunder, customers are customers of the clearing number; and

(9) the requirement to provide customer notification under paragraph [(d)]*(g)* of this Rule.

(b)(1) In order for the introducing member to carry out its functions and responsibilities under the agreement, each clearing member must forward promptly any written customer complaint received by the clearing member regarding the introducing member or its associated persons relating to functions and responsibilities allocated to the introducing member under the agreement directly to: (A) the introducing member; and (B) the introducing member's examining authority designated under Section 17 of the Act (''DEA'') (or, if none, to its appropriate regulatory agency or authority). The clearing or carrying agreement must specifically direct and authorize the clearing member to do so.

(2) The clearing member must also notify the customer, in writing, that it has received the complaint, and that the complaint has been forwarded to the introducing member and to the introducing member's DEA (or, if none, to its appropriate regulatory agency or authority). This written notice to the customer must also contain a statement that reads substantially as follows: ''Please be aware that you retain the right, at your discretion, to transfer your account to another broker/dealer of your choice.''

(c)(1) A clearing member, when it enters into a clearing agreement, must immediately, and annually thereafter, provide the introducing member a list or description of all reports (exception and other types of reports) which it offers to the introducing member to assist the introducing member in supervising its activities, monitoring its customer accounts, and carrying out its functions and responsibilities under the clearing agreement. The introducing member must notify promptly the clearing member, in writing, of those specific reports by the clearing member that the introducing member requires to supervise and monitor its customer accounts.

(2) The clearing member must retain as part of its books and records required to be maintained under the Act and the Association's rules, copies of the reports requested by or provided to the introducing member. For purposes of this Rule, the clearing member will be in compliance with the requirements of this paragraph it if retains the data from which the original report was produced, provided, the clearing member can, at the request of the DEA, either (A) recreate the report; or (B) provide the data and the data formatting that was used to prepare the report.

(3) Each year, no later than July 31, the clearing member must notify in writing the introducing member's chief executive and compliance officers of the reports offered to the introducing member and the reports requested by or supplied to the introducing member during the previous year ending June 30. The clearing member must also provide a copy of the notice to the introducing member's DEA.

(4) The clearing member must provide, at the request of the introducing member's DEA, any reports (or, if the reports are not available, information or data from which the