

or DPM. In making this determination, the Commission notes that any person adversely affected by a decision made under proposed Rule 8.95(c) has the right to a formal hearing, with the assistance of counsel, before the Exchange's Appeals Committee. Moreover, decisions of the Appeals Committee may be appealed to the Exchange's Board of Directors.

The Commission believes that the CBOE's proposed Rule 8.95(e)—which provides that the allocation of security to a trading crowd or a DPM, or the assignment of a trading crowd's or a DPM's location on the Exchange's floor, does not convey ownership rights in the allocation or location or associated order flow—merely reiterates the limited nature of those allocations, and highlights that the Exchange retains the authority to determine allocations and locations.

The Commission believes that the CBOE's proposed Rule 8.95(f), which provides special rules for option classes opened for trading prior to May 1, 1987, merely reflects existing practices that are consistent with the will of the Exchange's membership.

The Commission believes that the CBOE's proposed Rule 8.95(g), which states that in allocating and reallocating securities the Allocation Committee and the Special Products Assignment Committee shall act in accordance with restrictions and limitations established pursuant to other Exchange rules, ensures that proposed Rule 8.95 does not cause any inconsistencies with existing Exchange rules, and that other Exchange committees are not hindered in the exercise of their own responsibilities.

The Commission believes that the CBOE's proposed Rule 8.95, Interpretation .01, which provides that the Allocation Committee and the Special Products Assignment Committee are responsible for reallocating securities that are removed from a trading crowd or DPM pursuant to another rule, or when the trading crowd or DPM for some other reason no longer retains the allocation, subject to Rule 8.80(b)(6), clarifies in a reasonable and efficient way the respective responsibilities of those two committees and other Exchange committees such as the MTS Appointments Committee.

The Commission believes that the CBOE's proposed Rule 8.95, Interpretation .02, which provides that the Allocation Committee is responsible for relocating a trading crowd or DPM which is required to be relocated pursuant to another Exchange rule, clarifies the respective responsibilities

of the Allocation Committee and other Exchange committees.

Finally, the Commission believes that eliminating CBOE Rules 8.80(a) and 8.80(b)(7) current with the effectiveness of proposed CBOE Rule 8.95 will help avoid redundancies that may otherwise cause confusion. The Commission notes that Rule 8.80(b)(8) is made redundant by the elimination of Rule 8.80(b)(7), but the Exchange has stated that it is in the process of proposing to update and reorganize CBOE Rule 8.80, a process which will include the deletion of CBOE Rule 8.80(b)(8).<sup>12</sup>

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-CBOE-98-03), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39880; File No. SR-NASD-98-04]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Mandatory Arbitration of Claims Involving Exempted Securities

April 16, 1998.

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 January 27, 1998,<sup>1</sup> 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.

<sup>12</sup> See Amendment No. 3, *supra* note 3.

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> The NASD filed amendments to the proposed rule change on February 11, and March 31, 1998, the substance of which is incorporated into this notice. See letters from Elliott R. Curzon, Assistant General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Market Regulation, Commission, dated February 6, 1998 ("Amendment No. 1") and March 30, 1998 ("Amendment No. 2").

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

NASD Regulation is proposing to change the interpretation of the NASD's Code of Arbitration Procedure ("Code") such that claims relating to transactions in exempted securities, including government and municipal securities, may be submitted to the Office of Dispute Resolution ("Office") for arbitration under the Code without limitation. Accordingly, when such claims arise involving public customers, Rule 10301 of the Code will require member firms and associated persons to arbitrate them at the request of the customer. In addition, when such claims arise between members and other members or associated persons, Rule 10201 (which governs intra-industry disputes) will require them to be arbitrated at the request of one of the parties. Finally, when such claims arise between a member firm and a customer, customers may be required under the terms of a predispute arbitration agreement to arbitrate the claims.

#### 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.** Since at least 1989, the Office has declined to accept claims for mandatory<sup>2</sup> arbitration involving transactions in exempted securities<sup>3</sup> naming member firms that were

<sup>2</sup> "Mandatory" arbitration is when one party to a dispute is compelled to submit the claim to arbitration by rule or contract. For example, Rule 10201 of the Code requires members and associated persons to arbitrate claims at the request of another member or associated person, and Rule 10301 requires members and associated persons to arbitrate claims at the request of a customer.

<sup>3</sup> The term "exempted securities" is defined in Section 3(a)(12) of the Act, 15 U.S.C. 78c(a)(12), to mean government securities, municipal securities, and several other types of securities classified as exempted for specific purposes under the Act.

registered solely under Section 15C of the Act.<sup>4</sup> The Office will, however, accept claims where both parties agree to submit the claim to arbitration. If the claim involves a municipal securities transaction by a member firm,<sup>5</sup> the Office will accept the claim for arbitration, but will ask the claimants if they want the claim referred to the Municipal Securities Rulemaking Board ("MSRB") for arbitration.<sup>6</sup> Finally, if a claim involves a government securities transaction by a general securities broker/dealer member firm, the Office will accept the claim for mandatory arbitration.

Until recently, NASD Regulation had limited regulatory jurisdiction over member firm activities in connection with government securities and no jurisdiction over firms that engaged only in exempted securities activities. The policy with respect to accepting or rejecting claims for mandatory arbitration was based on the view that the subject matter jurisdiction of NASD Regulation's arbitration forum should not be significantly different from the regulatory jurisdiction of the NASD.

With the broadening of NASD Regulations's regulatory jurisdiction over government securities as a result of the Government Securities Act Amendments of 1993, and the recent adoption of amendments of the NASD's rules in recognition of the broader jurisdiction,<sup>7</sup> NASD Regulation has

revisited the policy. NASD Regulation believes it would be appropriate to include claims involving exempted securities by members engaged exclusively in exempted securities activities within the scope of those claims that are subject to mandatory arbitration under the Code.

*Discussion.* Rule 10101 of the Code provides that disputes "arising out of or in connection with the business of any member" are eligible for submission to arbitration under the Code. The definition of "investment banking or securities business" in Article I, paragraph (l) of the By-Laws means "the business carried on by a broker, dealer, or municipal securities dealer \* \* \*, or government securities broker or dealer \* \* \*." Rule 10301(a) provides that eligible disputes "arising in connection with the business of [a] member or in connection with the activities of [an] associated person" must be arbitrated pursuant to any enforceable arbitration agreement or upon the demand of a customer. While these rules (and the definition) sweep in a very broad range of disputes, Rule 10301(b) permits the Office to decline to arbitrate certain matters.

In reliance on Rule 10301(b), and the NASD's limited regulatory jurisdiction over government securities-only member firms, the Office has for many years declined to accept for arbitration claims that involved transactions in government securities by member firms engaged only in activities involving government securities unless both parties voluntarily agreed to submit the claim. The Office's position means that these claims cannot be compelled into arbitration under either a demand for arbitration or a predispute arbitration agreement. Members engaged in municipal securities transactions have been required to arbitrate their claims because they are either general securities broker/dealers that are otherwise required to arbitrate all of their other claims, or because they voluntarily became NASD members. The Office's decision to decline to mandate arbitration of government securities claims was based on the following rationale: (1) The NASD only regulated the exempted securities activities of member firms to the limited extent permitted in Section 15A(f)(2) of the Act; and, (2) the subject matter jurisdiction of the arbitration forum should not be significantly different from the NASD's regulatory jurisdiction over its members and associated persons.

In response to the passage of the Government Securities Act Amendments of 1993, which amended

Section 15A(f)(2) of the Act and granted the NASD the authority to regulate broadly the business practices of members with respect to government securities,<sup>8</sup> NASD Regulation amended its rules to consolidate the Government Securities Rules it had adopted pursuant to Section 15A(f)(2) of the Act with its more generally applicable Conduct Rules. NASD Regulation now regulates the activities of members engaged in government securities activities that are both general securities broker/dealers and limited purpose government securities broker/dealers.

NASD Regulation believes that with its broad new authority to regulate the government securities business of its members, it is appropriate to open its arbitration forum to disputes involving transactions in all kinds of securities, including exempted securities, consistent with the plain language of the Code and the By-Laws. While the subject matter jurisdiction of the arbitration forum now extends to municipal securities activities that are not strictly within the regulatory scope of NASD Regulation, such activities are "business" within the definitions of the By-Laws and the meaning of the Code. Moreover, NASD Regulation does not believe that there should be unreasonable barriers to customers seeking relief in arbitration for claims relating to the business of members. Therefore, compelling NASD members to arbitrate municipal securities claims would be consistent with the intent of the MSRB's rule filing.<sup>9</sup>

Under this policy, a member that is registered solely as a government securities broker/dealer and that has a dispute with a customer over a transaction in exempted securities shall be required to submit the dispute to arbitration upon the demand of the customer.<sup>10</sup> Such disputes also may be compelled to arbitration pursuant to a valid predispute arbitration agreement. Intra-industry disputes involving exempted securities also will be subject to mandatory arbitration upon the request of one of the parties.

NASD Regulation also believes the policy should permit any claim involving exempted securities to be submitted for arbitration without regard to when the transaction occurred;

<sup>8</sup> The NASD is still barred from establishing regulations covering the municipal securities activities of broker/dealers; that authority is reserved to the MSRB.

<sup>9</sup> See footnote 6, *supra*.

<sup>10</sup> NASD Regulation notes that few government securities claims involving public customers have been filed or attempted to be filed with the Office. Most of the claims involving government securities have involved member-to-member claims.

<sup>4</sup> Section 15C of the Act, 15 U.S.C. 78o-5, governs the registration of government securities broker/dealers. Since 1986, when Section 15C was adopted under the Government Securities Act, government securities broker/dealers have been required to become members of an exchange or the NASD.

<sup>5</sup> Section 15B of the Act, 15 U.S.C. 78o-4, governs the registration of municipal securities dealers. Municipal securities dealers are not required to become members of an exchange or the NASD. Nevertheless, some NASD members which are engaged in a general securities business are registered as municipal securities dealers, and some firms which are exclusively municipal securities dealers have become members of the NASD.

<sup>6</sup> Rule 10301(c) of the Code permits claims "which arise out of a readily identifiable market" to be referred to the arbitration forum for that market if the claimant consents. Since this provision was adopted, the Office will ask the claimants in a case involving municipal securities if they want their case referred to the MSRB. No cases have been referred, and the Commission recently approved an MSRB proposed rule change that terminates the MSRB's arbitration program and requires the financial institutions that are subject to its rules to submit to arbitration in the NASD's forum as if they were NASD members. See Securities Exchange Act Release No. 39378 (December 1, 1997), 62 FR 64417 (December 5, 1997).

<sup>7</sup> In Notice to Members 96-66, published in October 1996, the NASD announced the consolidation of its Government Securities Rules into the Conduct Rules, ending the regulatory distinction between the activities of general securities broker/dealers and government securities broker/dealers.

however, if more than six years have elapsed from the transaction, occurrence, or event giving rise to the claim, under Rule 10304 of the Code, the claim will not be eligible for submission to arbitration.<sup>11</sup> All claims involving general securities broker/dealers will continue to be accepted for arbitration consistent with past practice. Claims previously submitted that the Office has already declined to arbitrate under the old policy cannot be resubmitted under the policy being announced herein.

## 2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act<sup>12</sup> in that eliminating a barrier to the arbitration of disputes involving exempted securities, public customers and members will have access to a fair, efficient, and cost-effective forum for the resolution of such disputes.

### *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,

including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 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-98-04 and should be submitted by May 14, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39883; File No. SR-NASD-97-69]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change, as Amended, and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Tape Recording of Conversations

April 17, 1998.

#### I. Introduction

On September 12, 1997, the National Association of Securities Dealers, Inc. ("NASD"), through its regulatory subsidiary NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> In this filing, NASD Regulation proposed amendments to Rule 3010 to

require the tape recording of conversations where members hire more than a specified percentage of registered persons from certain firms that have been expelled or that have had their broker/dealer registration revoked for violations of sales practices rules. The proposed rule change also includes a conforming rule change to Rule 9610. Notice of this proposed rule change was published in the **Federal Register** on December 5, 1997 (as amended, the "Notice").<sup>3</sup> The Commission received one comment letter, which expressed concerns about using tape recording as a method of supervision, in response to the Notice.<sup>4</sup> On March 9, 1998, NASD Regulation filed Amendment No. 2 with the Commission.<sup>5</sup> This order approves the rule change, as amended, and grants accelerated approval of Amendment No. 2 to the rule change.

#### II. Background

At its meeting in July 1996, the NASD Regulation Board of Directors authorized the staff to issue a Notice to Members soliciting comment on proposed changes to NASD supervisory Rule 3010 to require the tape recording of telephone conversations of registered representatives in certain circumstances. The Rule was developed both to respond to concerns expressed in the *Joint Regulatory Sales Practice Sweep ("Sweep") Report*<sup>6</sup> regarding the

<sup>3</sup> See Securities Exchange Act Release No. 39361 (November 26, 1997), 62 FR 64422 (File No. SR-NASD-97-69). Amendment No. 1 to the proposed rule filing was filed on November 12, 1997. The changes contained in this amendment were included in the Notice. See Letter from Mary N. Revell, Associate General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission (November 17, 1997).

<sup>4</sup> See Letter from R. Gerald Baker, Securities Industry Association ("SIA"), to Jonathan G. Katz, Secretary, Commission, dated February 11, 1998.

<sup>5</sup> See letter from Mary N. Revell, Associate General Counsel, NASD Regulation, to Katherine A. England, Assistant Director, Office of Market Supervision, Division of Market Regulation (March 9, 1998). In Amendment No. 2, NASD Regulation: (1) Applies the proposal to firms that have a work force comprised of a specified number of registered persons who were employed by a "disciplined firm" within the last three years instead of two years; (2) requires firms to establish special procedures to supervise the telemarketing activities of registered persons instead of registered representatives; (3) amends the definition of registered persons to include those persons who register as municipal securities principals or representatives pursuant to Municipal Securities Rulemaking Board Rule G-3; and (4) provides guidance on what would constitute "reasonable procedures for reviewing the tape recordings made pursuant to the requirements of" the taping rule in a Notice to Members announcing approval of the rule.

<sup>6</sup> Staffs of the NASD, New York Stock Exchange ("NYSE"), North American Securities Administrators Association ("NASAA"), and the Office of Compliance Inspections and

<sup>11</sup> NASD Regulation notes that it has a proposed amendment to Rule 10304, rule filing SR-NASD-97-44, pending approval with the SEC. Under the proposed rule change all claims are presumed to be eligible; however, the presumption can be overcome if the respondent challenges the claim on the basis that more than six years have elapsed since the act or occurrence giving rise to the claim.

<sup>12</sup> 15 U.S.C. 78-3.

<sup>13</sup> 17 CFR 200.30-3(a)(12).

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

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