

**MEMO# 16567**

September 22, 2003

## **BROKER-DEALER CENSURED AND FINED FOR VIOLATING NASD NON-CASH COMPENSATION RULES**

[16567] September 22, 2003 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 73-03 COMPLIANCE ADVISORY COMMITTEE No. 76-03 SEC RULES MEMBERS No. 125-03 UNIT INVESTMENT TRUST MEMBERS No. 29-03 RE: BROKER-DEALER CENSURED AND FINED FOR VIOLATING NASD NON-CASH COMPENSATION RULES NASD has censured and fined a broker-dealer firm for conducting prohibited sales contests for its brokers and managers to promote the sale of the firm's proprietary mutual funds and certain variable annuities.<sup>1</sup> According to NASD, these contests, which consisted of various forms of non-cash compensation, such as firm-sponsored trips, concerts, sporting events, etc., violated NASD Conduct Rules 2830 (mutual funds) and 2820 (variable annuities) because (1) the non-cash compensation arrangements between the firm and its associated persons were not based on the "total production" of associated persons with respect to all mutual funds or variable annuities distributed or offered by the firm, and (2) the credit received for sales of each mutual fund or variable annuity was not "equally weighted" for contest purposes.<sup>2</sup> NASD also alleged that the firm violated NASD Conduct Rules 3010 and 2110 by failing to establish and maintain supervisory and compliance systems and procedures to detect and prevent such conduct. The firm also allegedly violated the rules when, acting through one of its managing directors, it failed to reasonably supervise its financial advisor network with a view toward preventing such violations. Without admitting or denying NASD's allegations, the broker-dealer and the managing director agreed to be censured and fined \$2 million and \$250,000, respectively. In addition, the firm agreed to retain an independent consultant to recommend revisions to the firm's supervisory and compliance procedures and systems related to the non-cash compensation rules, and to implement such recommendations and provide a copy of them, along with proof of their implementation, to the NASD's Department of Enforcement. The firm also agreed to 1 A copy of the NASD's Letter of Acceptance, Waiver and Consent is attached. An NASD press release describing this matter is available from the NASD's website at [http://www.nasdr.com/news/pr2003/release\\_03\\_039.html](http://www.nasdr.com/news/pr2003/release_03_039.html). 2 NASD Conduct Rules 2830 and 2820, among other things, prohibit non-cash compensation arrangements between members and their associated persons for sales of mutual funds and variable annuities that are not based on concepts of "total production" and "equal weighting." 2 designate a registered principal with the responsibility for updating and amending the firm's compliance systems and procedures consistent with NASD rules and regulations. Barry E. Simmons Associate Counsel Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for

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