

**MEMO# 8046**

July 10, 1996

## **NASD NON-CASH COMPENSATION PROPOSAL**

1 See Memorandum to Closed-End Fund Members No. 25-95, SEC Rules Members No. 46-95 and Unit Investment Trust Members No. 36-95, dated July 20, 1995. July 10, 1996 TO: CLOSED-END FUND COMMITTEE No. 18-96 SEC RULES COMMITTEE No. 72-96 UNIT INVESTMENT TRUST COMMITTEE No. 27-96 RE: NASD NON-CASH COMPENSATION PROPOSAL

The SEC has issued for public comment proposed amendments to the rules of the NASD governing non-cash compensation. In most respects, the proposed amendments are similar to those set forth in NASD Notice to Members 95-56 (July 1995).<sup>1</sup> A copy of the SECs notice is attached. Comments on the proposed amendments are due Monday, July 29. Please call Frances Stadler at 202/326-5822 with any comments you have on the proposal by no later than Friday, July 19. The proposed amendments would permit NASD members and their associated persons to receive non-cash compensation only in specified circumstances. All other forms of non-cash compensation would be prohibited. "Non-cash compensation" would be defined to include compensation received in connection with the sale of investment company shares, other than cash compensation, including but not limited to merchandise, gifts and prizes, and payment of travel expenses, meals and lodging. The following types of non-cash compensation would be permitted: (1) gifts to associated persons of up to \$100 annually that are not preconditioned on achieving a sales target; (2) an occasional meal, ticket to a sporting event or theater, or comparable entertainment for associated persons and their guests that is not so frequent or extensive to raise any question of propriety and is not preconditioned on achieving a sales target; (3) payment or reimbursement in connection with training or educational meetings, subject to several conditions, including that the location of the meeting is appropriate for its purpose and that such payment or reimbursement is not preconditioned on achieving a sales target; and (4) in-house incentive programs, subject to various conditions, including that the program give equal credit for each sale of an investment company security (and, thus, does not treat sales of proprietary funds more favorably). Non-member firms would be permitted to contribute to such in-house incentive programs, but could not otherwise participate in the organization of such a program. The proposed amendments also would prohibit the receipt by associated persons of cash compensation preconditioned on the achievement of a sales target unless the program satisfied conditions similar to those required for in-house non-cash incentive programs. Non-member firms could contribute to such programs. The SECs release states that these arrangements were included in order "to ensure that offerors do not circumvent the non-cash incentive prohibition through the offering of cash incentives directly to associated persons." The release further states that "the focus of the prohibition does not include other cash revenue-sharing arrangements." Such arrangements are the subject of a study being conducted by the NASD staff. The study is anticipated to result in

further rule proposals governing the disclosure of revenue sharing arrangements. The current proposed amendments would not change the existing prospectus disclosure requirements with respect to cash compensation arrangements. Because of the limits that would be placed on them under the proposed amendments, non-cash compensation arrangements would no longer be subject to the prospectus disclosure requirements. The current prohibition on compensation in the form of securities would be retained. The proposed amendments also would establish a general exception for arrangements that are permitted by an SEC rule, regulation, interpretive release, or interpretive or no-action letter and that meet certain other conditions. The SECs release cites Chubb Securities Corporation (Nov. 24, 1993), which permitted financial institutions to make commission payments to dual employees of the financial institution and a broker-dealer, as an example of such a letter. The proposed amendments would establish a new recordkeeping requirement. NASD members would be required to maintain records of all cash and non-cash compensation received by the member or its associated persons from investment companies and affiliates. The records would include, among other things, the amount of any cash and the nature and, if known, the value of any non-cash compensation received. Non-cash compensation awarded pursuant to the exceptions for gifts of no more than \$100 and for occasional tickets, meals, etc. would not be subject to the recordkeeping requirements. If the proposed amendments are approved by the SEC, the NASD will issue a Notice to Members within 60 days, and the amendments will be effective on the date of that Notice. The SECs release states that "no new sales incentive programs may be commenced" after the effective date, but presumably new programs that satisfy the amended rules conditions could be commenced after that date. In the case of programs in existence on the effective date, sales may continue to be applied to such programs for six months after the effective date and cash and non-cash incentives earned by associated persons could continue to be received "for a period not to exceed twelve months following the expiration of the six-month implementation period in the next calendar year after approval of the amendments by the SEC." In addition to seeking general comments on the NASDs proposal, the SECs release seeks comment on several specific matters, including (1) whether non-cash compensation in the form of gifts of no more than \$100 and occasional meals, tickets, etc. should be subject to the recordkeeping requirements, (2) whether the recordkeeping requirements will be sufficient to enable the NASD to determine that training and educational meetings are held at appropriate locations, (3) whether, as under the proposed amendments, training and educational meetings should be treated differently, depending on whether they are sponsored by a member firm for its associated persons or by an investment company or affiliate and on whether an investment company or affiliate contributes to the meeting, and (4) whether the proposal should be extended to address other instances of differential compensation for proprietary products, as opposed to non-proprietary products. Craig S. Tyle Vice President and Senior Counsel Attachment