

MEMO# 10164

July 31, 1998

SEC APPROVES NASD NON-CASH COMPENSATION PROPOSAL

1 SEC Release No. 34-40214 (July 15, 1998), 63 Fed. Reg. 39614 (July 23, 1998). 2 The NASD will issue a Notice to Members setting forth the text of the rule amendments. The Notice also will announce the effective date of the rule amendments and explain how they will be implemented. Previously, the NASD proposed to implement the rule amendments as follows. As of the effective date, no new sales incentive programs (presumably other than those permitted under the rule amendments) could be commenced. Sales incentive programs that are ongoing as of the effective date could continue for up to six months. Sales incentives earned by associated persons would be permitted to be received for up to twelve months following the expiration of the six-month period. (The attached release indicates that, in response to an Institute comment, the NASD will clarify that the implementation provisions apply to non-cash sales incentives.) 3 See Memorandum to Closed-End Investment Company Members No. 26-97, SEC Rules Members No. 66-97 and Unit Investment Trust Members No. 35-97, dated September 10, 1997. [10164] July 31, 1998 TO: SALES FORCE MARKETING COMMITTEE No. 16-98 RE: SEC APPROVES NASD NON-CASH COMPENSATION PROPOSAL

The Securities and Exchange Commission has approved the NASD's proposed amendments to its rules governing non-cash compensation. A copy of the SEC release is attached.¹ Although the text of the final amendments is not included in the release,² it appears that they will be very similar to the proposed amendments that the SEC published for comment last year.³ The final rule amendments are summarized below. According to the attached release, the amendments will prohibit, with certain exceptions, members and persons associated with members from directly or indirectly paying or receiving any non-cash compensation in connection with the sale of investment company securities. Excepted from the prohibition are: (1) gifts of up to \$100 per associated person annually; (2) an occasional meal, ticket to a sporting event or theater, or comparable entertainment; (3) payment or reimbursement for training and educational meetings held by a broker-dealer or mutual fund for the associated persons of broker-dealers, if certain conditions are met; (4) in-house sales incentive programs of broker-dealers for their own associated persons; (5) sales incentive programs of mutual funds for the associated persons of an affiliated broker-dealer; and (6) contributions by any non-member company or other member to a broker-dealer's permissible in-house sales incentive program. As had been proposed, cash and non-cash compensation arrangements will be subject to certain recordkeeping requirements. Only cash compensation arrangements will be subject to prospectus disclosure requirements. The release notes that "NASD Regulation has stated in the proposed rule change that it will reevaluate prospectus disclosure in light of the SEC's recent initiatives for a simplified prospectus." ²According to the attached release, the NASD

did not adopt the Institute's recommendation that the rules should permit in-house incentive programs where the compensation is based on sales of investment company securities within a broad investment objective or category, rather than all investment company securities sold by the member. As suggested by the Institute, however, the NASD did revise the proposal to clarify that a member may contribute to a non-cash compensation arrangement of a non-member, if that arrangement complies with the conditions of the rule. Consistent with another comment made by the Institute, the release also clarifies the ability of NASD members and funds to determine attendance by the member's associated persons at training or education programs. Specifically, the release indicates that a member or fund may make payments or reimbursements for a training or education program aimed at the member's top producers during a given time period, so long as payment is not earned through a member's in-house sales incentive program, through the sales incentive program of a member's non-member affiliate, or preconditioned on achieving a sales target. The release indicates that although some commenters urged the NASD to defer action on the non-cash compensation proposal until it addresses cash compensation, "the NASD has taken considerable steps over the past decade to address concerns raised by non-cash compensation arrangements, and, accordingly, the Commission believes it is appropriate for the NASD to address non-cash compensation arrangements at this time, while continuing to consider the most appropriate regulatory approach to cash compensation arrangements made in connection with mutual fund and variable contract sales." Frances M. Stadler Deputy Senior Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at (202)326- 8304, and ask for this memo's attachment number: 10157.