

variable contracts.<sup>4</sup> These amendments generally limited the manner in which members can pay for or accept non-cash compensation and detail the types of non-cash compensation that are permissible. The amendments also provided limited exceptions to the non-cash compensation restrictions for payments or reimbursements that are in connection with training and education meetings. The 1999 amendments also defined certain key terms, such as "compensation" and "non-cash compensation."

Current provisions of the Corporate Financing rule and the DPP rule limit the receipt of non-cash compensation by member firms and associated persons in connection with the sale and distribution of DPP securities, REIT programs, and corporate debt and equity offerings. These types of non-cash compensation, adopted in 1988, are not as comprehensive as the restrictions that were later adopted in the Variable Contracts rule and the Investment Company rule in 1999.

Generally, consistent with the current non-cash compensation requirements in NASD rules 2820 and 2830, the proposed rule change will conform the text of NASD rules 2710 and 2810 to rules 2820 and 2830: (1) Adopt definitions of the terms "compensation," "non-cash compensation," and "offeror;" (2) provide express exceptions from the non-cash compensation limitations for *bona fide* training and education meetings; and (3) prohibit, with certain exceptions, members or persons associated with members from directly or indirectly accepting or paying any non-cash compensation in connection with public offerings of debt or equity securities or transactions in direct participation programs.

Consistent with NASD rules 2820 and 2830, the proposed rule change will provide express exceptions from the non-cash compensation provisions that would permit: (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 education meetings held by broker-dealers or issuers/sponsors for the purpose of educating associated persons of broker-dealers, so long as certain conditions are met; (4) in-house sales incentive programs of broker-dealers for their own associated persons; and (5) contributions by any non-member

company or other member to a broker-dealer's permissible in-house sales incentive program, provided there is compliance with certain criteria.

NASD staff has consistently been concerned about the use of sales incentives in connection with the sale of any type of securities to a member's customers, including transactions in DPP securities, REIT programs, and corporate debt and equity offerings. For example, these incentive programs may offer registered representatives exotic trips or expensive merchandise if they sell a specific dealer's product. The NASD believes that the potential conflicts of interest that arise from the receipt of non-cash compensation in connection with the sale of variable products and mutual fund securities also exist in connection with the sale of these types of securities.

Since January 1999, through interpretive advice, responses to exemptive requests, and in the course of the filing review process under the DPP and Corporate Financing rules, NASD staff has consistently applied the non-cash compensation prohibitions in NASD rules 2820 and 2830 to sales of variable annuities, mutual funds, DPP securities, REIT programs, and corporate debt and equity offerings. Accordingly, although training and education meetings are not specifically permitted under the DPP and Corporate Financing rule, the NASD has recognized that *bona fide* training and education meetings that meet the strict requirements set out in the Variable Contracts rule and Investment Company rule can be held consistent with the non-cash compensation prohibitions.

**DPP Rule.** Paragraph (b)(4)(E) of the DPP rule currently prohibits a member or associated person from accepting, directly or indirectly, non-cash compensation or sales incentive items from any sponsor or affiliate of a sponsor, unless the following requirements are satisfied: (1) The aggregate value of all such items received annually does not exceed \$100; (2) the value of all such items is included as compensation received in connection with the offering; and (3) the proposed payment of such items is disclosed in the prospectus.

The DPP rule currently does not contain an exception for training and education meetings. Through interpretive advice, the NASD has approved members' receipt of non-cash compensation in connection with *bona fide* training and education meetings. The NASD considers such a meeting to be one that educates registered representatives and assists them in making a suitability determination

regarding a DPP product for their customers and that is otherwise in compliance with the training and education provisions of NASD rules 2820 and 2830. In Notice to Members 85-29 (April 1985), the NASD announced that reimbursement for training and education meetings is permitted under the DPP rule if the expenses are recognized as underwriting compensation, disclosed in the prospectus, and come within the 10% limit on underwriting compensation permitted under the rule. NASD staff has consistently applied the 10% compensation limit and training and education policies in the DPP rule set forth in Notice to Members 85-29 to REIT offerings that are filed with the Corporate Financing Department under the Corporate Financing rule.

**Corporate Financing Rule.** Although the rule language of the non-cash compensation provision in the Corporate Financing rule is different from the language of the non-cash compensation provision in the DPP rule, paragraph (c)(6)(B)(xiii) of the Corporate Financing rule currently contains a provision that prohibits a member or associated person from accepting, directly or indirectly, non-cash compensation or sales incentive items in excess of \$100 per person per issuer annually from any issuer or affiliate thereof. The rule does not contain an exception for training and education meetings.

**Training and Education Meetings.** Currently, both the Variable Contracts rule and the Investment Company rule contain an express exception to the non-cash compensation provisions for training and education meetings that the industry believes are necessary to educate representatives about their products. The rules, however, contain conditions that must be satisfied before the exception can be used. Specifically, they require prior approval of attendance by the associated person from his or her member firm, satisfaction of the recordkeeping requirements, that attendance at the meeting not be preconditioned on the achievement of a sales target, that the location of the meeting be an office of the offeror or facility in the vicinity of the office, and that no reimbursement be provided for expenses of a guest.

Since the adoption of these provisions, the NASD has issued strict guidelines on the appropriate use of the training and education exception through Regulatory & Compliance Alerts, interpretive letters, and other correspondence with members. This guidance has stated that a sponsor is not permitted to pay for certain expenses in

<sup>4</sup> See Securities Exchange Act Release No. 40214 (July 15, 1998), 63 FR 39614 (July 23, 1998) (SR-NASD-97-35).