

# Notice to Members

SEPTEMBER 2003

REQUEST FOR COMMENT

ACTION REQUESTED BY OCTOBER 10, 2003

## SUGGESTED ROUTING

Legal & Compliance  
Senior Management

## Supervision Rules

NASD Requests Comment on Proposed Amendments to Rule 3010 to Require Heightened Supervision Plans for Associated Persons with a Specified Threshold of Industry/Regulatory-Related Events; **Comment Period Expires October 10, 2003**

## KEY TOPICS

Rule 3010  
Supervisory Systems

## Executive Summary

NASD requests comment on proposed amendments to Rule 3010 (Supervision) to require members to adopt heightened supervision plans for those associated persons who have met or exceeded specified threshold numbers of industry/regulatory-related events, or to document their rationale (which must be reasonable) for not doing so. Rule 3010 generally requires members to establish and maintain supervisory systems for each of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and NASD rules. However, the rule does not specifically address supervision of associated persons with a history of industry/regulatory-related events. The proposed rule change is intended to bolster investor protection by promoting earlier and more effective detection, and thus prevention, of future sales practice and other regulatory abuses by the associated person(s) requiring heightened supervision. In connection with the heightened supervision requirement, NASD seeks comment on the types and frequency of incidents that should be considered in requiring that persons be subject to heightened supervision plans.

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NASD further requests comment on amendments that would require that the registered person responsible for supervising the activities of the associated person(s) subject to the plan approve in writing the heightened supervision plans. As part of the approval of the plan, the supervisor would acknowledge responsibility for execution of the plan. This rule change is intended to ensure effective implementation of the heightened supervision plans and coordination between the personnel responsible for hiring and compliance personnel by encouraging more awareness and careful consideration of a person's background during the hiring process.

### Questions/Further Information

Questions regarding this *Notice to Members* may be directed to Grace Yeh, NASD Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-6939.

### Request for Comment

NASD requests comment on the proposed amendments to Rule 3010 described in this *Notice*. Members wishing to comment must make a submission that is received by **October 10, 2003**. Members and interested persons can submit their comments using the following methods:

- ◆ mailing in written comments
- ◆ e-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com)
- ◆ submitting comments online at the NASD Web Site ([www.nasd.com](http://www.nasd.com))

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
1735 K Street, NW  
Washington, DC 20006-1500

**Important Note:** The only comments that will be considered are those submitted by mail, e-mail, or via the NASD Web Site.

Before becoming effective, any rule change developed as a result of responses received to this *Notice* must be approved by the Securities and Exchange Commission (SEC).

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## Background and Discussion

Supervisory systems are a basic component of self-regulation within the securities industry. An effective supervisory system plays an essential role in the prevention of sales practice and other abuses and, thus, enhances investor protection and market integrity. As such, it is essential that firms monitor the regulatory histories of their associated persons and establish additional measures to supervise the activities of those associated persons with greater potential of creating customer harm.

Persons who have engaged in certain types of serious misconduct become subject to statutory disqualification under the federal securities laws and NASD rules and are required to undergo an eligibility proceeding.<sup>1</sup> In such a proceeding, NASD may seek to prevent the entry or continuance in the securities industry of persons subject to a statutory disqualification, or may permit them to work if the employment is consistent with the public interest and protection of investors. NASD, in virtually every instance where continued employment is permitted, will condition employment of the individual on the establishment of safeguards, including enhanced supervision by the employer member of the individual's business activities.

Neither the federal securities laws nor NASD rules, however, explicitly address members' supervisory obligations with respect to associated persons who have a history of industry/regulatory-related incidents, but who fall short of triggering the statutory disqualification provisions. Rule 3010 generally requires members to establish and maintain supervisory systems for each of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and NASD rules, but the rule does not specifically address supervision of associated persons with a history of industry-related events.<sup>2</sup> *Notices to Members* issued in this area have provided guidance for members concerning heightened supervision plans for associated persons with these types of histories, but the guidance has not been incorporated into NASD rules.<sup>3</sup>

Accordingly, to address regulatory concerns raised by associated persons with these histories, NASD is seeking comment on the adoption of rule amendments to require explicitly that members adopt heightened supervision plans for those associated persons who meet or exceed threshold numbers of industry/regulatory-related incidents (such as customer complaints, arbitration proceedings, terminations for cause, and disciplinary actions). Along with numerical threshold tests, NASD recognizes that a qualitative analysis of the associated persons' activities also is an important tool for identifying whether they require heightened supervision. As such, the proposed amendments would provide firms with the flexibility not to impose a heightened supervision plan on a particular individual based upon a qualitative review of the activities of that individual. If a member decides not to impose heightened supervisory procedures on a person who has met one or more of the triggers, the member must document a clear, well-reasoned rationale supporting its determination. NASD requests comment on whether firms that have a certain number of associated persons who meet the heightened supervision requirements should not be allowed to opt-out of the heightened supervision requirement, and, if so, what this threshold number should be.

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As required by Rule 3010, any supervision plan should be reasonably designed to ensure compliance with applicable securities laws and regulations and NASD rules. However, members would have the flexibility to tailor the plans to fit the firm's business and to address the nature of the concerns raised by the associated person's industry/regulatory-related incidents. Members also would have discretion in determining the duration of a heightened supervision plan, based on the member's reasonable assessment of the facts and circumstances surrounding the particular associated person's activities. While a member would be expected to maintain any heightened supervision plan imposed until such time that the associated person no longer meets any of the triggers for heightened supervision, the member may determine to eliminate such plan earlier provided the member provides a reasonable rationale for the earlier termination.

The proposed amendments would require that the plans be approved in writing by the person responsible for supervising the associated person subject to the plan. As part of the approval of the plan, such supervisor would acknowledge responsibility for execution of the plan. NASD believes that requiring approval and acknowledgement by a supervisor would help to ensure effective implementation of the plans as well as an even more careful consideration of an associated person's background in the hiring process. In addition, as required by Rule 3010(b)(4), members would need to maintain such plans in their firm records. NASD staff would review the plans as part of the examination program.

As part of this initiative, NASD staff has reviewed CRD data regarding industry/regulatory events for persons currently registered with NASD to determine what numerical tests would be appropriate as triggers to require firms to assess whether to impose a heightened supervision plan. A preliminary review of existing data as reported to the CRD system indicates that 29,500 out of the 663,000 persons currently registered with NASD (approximately four percent of currently active registered persons) have been subject to one or more customer complaints and arbitrations within the last five years. Of this number, 2,751 persons (.41 percent of all registered persons) have had three or more complaints and arbitrations.<sup>4</sup>

Based on this preliminary data, NASD proposes that members be required to impose (or document their rationale, which must be reasonable, for not imposing) heightened supervision plans on any associated person subject to three or more customer complaints and arbitrations within the past five years, given that three or more complaints and arbitrations is an unusually high number of complaints and arbitrations in the industry. Similarly, NASD proposes that members be required to impose heightened supervision plans on their associated persons who, within the previous five years, were subject to three or more pending, adjudicated, or settled regulatory actions or investigations,<sup>5</sup> or two or more terminations relating to regulatory or compliance issues or internal reviews initiated by an employing member firm to examine whether an individual engaged in misconduct.<sup>6</sup> The preliminary universe of persons reported in this *Notice* who would trigger the heightened supervision requirement include some overlap between categories as well as overlap due to a positive reporting in more than one category based on the same incident. NASD intends to periodically review the methodology to ensure that the appropriate associated persons are identified for heightened supervision.

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Finally, while the proposed amendments would require members to adopt heightened supervision plans (unless members document their rationale for not imposing heightened supervision) if certain triggers are reached, members would continue to be obligated to review those associated persons with lower numbers of the events discussed in this *Notice*, other regulatory and litigation events, or other instances where they are the subject of internal actions by members to caution, discipline, or limit their activities, to determine whether heightened supervision plans or other measures are needed.

## Endnotes

- 1 Events triggering statutory disqualification include, for example, certain enumerated misdemeanor and all felony criminal convictions for a period of ten years from the date of conviction; temporary and permanent injunctions (regardless of their age) involving a broad range of unlawful investment activities; bars (and current suspensions) ordered by the SEC or a self-regulatory organization (SRO); and findings that a person willfully has made or caused to be made false statements of a material fact to an SRO. See Sections 3(a)(39) and 15(b)(4)(A) of the Securities Exchange Act of 1934; NASD By-Laws Article III, Section 4. Persons who are or become subject to a statutory disqualification may seek to enter, reenter, or in the case of incumbents, continue in the securities industry.
- 2 Rule 3010(a)(7) requires that members conduct annual meetings with their registered representatives at which compliance matters relevant to the activities of the representatives are discussed, but does not require that members take supervisory steps tailored to specific incidents concerning the registered representatives.
- 3 See *Notice to Members 97-19* (April 1997) stating that a member with a registered representative who develops a history of customer complaints, final disciplinary actions involving sales practice abuse or other customer harm, or adverse arbitration decisions should consider developing special supervisory procedures for that registered representative. See also *Notice to Members 98-38* (May 1998) indicating that unexpected supervisory visits to offices with personnel who have disciplinary records may be appropriate.
- 4 The preliminary data show that of the 29,500 persons subject to customer complaints within the last five years, 3.3 percent of all registered persons (22,003 persons) were subject to 1 complaint, .71 percent of all registered persons (4,726 persons) were subject to 2 complaints, .22 percent of all registered persons (1,487 persons) were subject to three complaints, .09 percent of all registered persons (568 persons) were subject to four complaints, and .04 percent of all registered persons (290 persons) were subject to 5 complaints.
- 5 Preliminary data indicate that .52 percent of all persons currently registered with NASD (3,446 persons) have been subject to regulatory actions or investigations within the last five years. Of those subject to such actions/investigations, only .03 percent of all registered persons (216 persons) were subject to three or more.
- 6 Preliminary data indicate that .37 percent of all registered persons (2,475 persons) have been terminated or been the subject of an internal review initiated by the firm based on alleged investment-related misconduct. Of those persons, .18 percent of all registered persons (1,198 persons) had two or more such incidents.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### 3010. Supervision

(a) No change.

(b) **Written Procedures**

(1) and (2) No change.

(3) Heightened supervisory procedures

(A) Each member that either is notified by NASD or otherwise has knowledge that any of its associated persons meets one of the criteria in paragraph (b)(3)(D) shall establish, maintain, and enforce special written procedures for supervising the activities of such associated persons.

(B) The member must establish and implement the supervisory procedures required by this paragraph within 30 days of receiving notice from NASD or obtaining actual knowledge that it is subject to the provisions of this paragraph.

(C) The procedures required by this paragraph must be appropriate for the member's business, size, structure, and customers and must be reasonably designed to supervise the types of activities that gave rise to the special supervision required by this paragraph.

(D) Members shall be required to adopt special supervisory procedures over the activities of the following associated person(s):

- The associated person has been subject to three or more customer complaints and arbitrations (as reported on Item 14I on Form U-4) in the previous five years;
- The associated person has been subject to three or more pending, adjudicated, or settled regulatory actions or investigations by the Commission, the Commodity Futures Trading Commission, a federal, state, or foreign regulatory agency, or a self-regulatory organization in the previous five years; or

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- The associated person has been subject to two or more terminations for cause or internal reviews for alleged investment-related misconduct in the previous five years.

(E) A member must maintain the special supervisory procedures until such date that the associated person no longer meets any one of the criteria in paragraph (b)(3)(D), unless the member documents reasonable rationale for earlier termination of such procedures.

(F) If a member determines not to adopt special supervisory procedures for an associated person who meets one or more of the criteria in paragraph (b)(3)(D), the member must have a reasonable basis for its determination, which must be documented.

(G) The special supervisory procedures established under this paragraph must be approved, in writing, by a person supervising the associated person subject to the special supervisory procedures. The approving supervisor must also acknowledge responsibility for implementation and execution of the special supervisory procedures.

(4) [(3)] The member's written supervisory procedures shall set forth the supervisory system established by the member pursuant to paragraph (a) above, and shall include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and the Rules of this Association. The member shall maintain on an internal record the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective. Such record shall be preserved by the member for a period of not less than three years, the first two years in an easily accessible place.

(5) [(4)] A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations, including the Rules of this Association, and as changes occur in its supervisory system, and each member shall be responsible for communicating amendments through its organization.

(c) - (g) No change.

# Special Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal and Compliance  
Mutual Fund Sales  
Operations  
Senior Management

## KEY TOPICS

Mutual Fund Transactions

## ACTION REQUIRED

### Mutual Fund Transactions

NASD Reminds Member Firms of their Obligations Regarding Mutual Fund Transactions and Directs Review of Policies and Procedures

#### Executive Summary

Investment Company Act Rule 22c-1(a) generally requires that redeemable securities of investment companies be sold and redeemed at a price based on the net asset value (NAV) of the fund computed **after** the receipt of orders to purchase. It is a violation of NASD Rule 2110, and may be a violation of the federal securities laws and NASD Rule 2120, for member firms and their associated persons to knowingly or recklessly effect mutual fund transactions that are priced based on NAV that is computed prior to the time the order to purchase or redeem was given by the customer. Furthermore, it may be a violation of NASD Rule 2110 and the federal securities laws to knowingly or recklessly facilitate certain mutual fund transactions, such as market timing transactions, in conjunction with, or with the acquiescence of, a mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person<sup>1</sup> where those other parties acted contrary to a representation made in the prospectus or statement of additional information pursuant to which the mutual fund shares are offered.

NASD is issuing this *Notice to Members* to (1) remind members of their responsibility to ensure that they have policies and procedures reasonably designed to detect and prevent the occurrence of mutual fund transactions that would violate NASD Rule 2110 and the federal securities laws; and (2) direct each member firm executing mutual fund sales and redemptions to review its policies and procedures to assure that they are adequate with respect to the matters that are discussed in this *Notice to Members*.

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## Questions/Further Information

Questions concerning this *Notice* may be directed to Marc Menchel, Executive Vice President and General Counsel, Regulatory Policy and Oversight, NASD (202) 728-8071; Daniel M. Sibears, Senior Vice President & Deputy, Department of Member Regulation, Regulatory Policy and Oversight, NASD (202) 728-8221; or Tom Selman, Senior Vice President, Investment Companies/Corporate Finance, NASD (240) 386-4500.

## Discussion

Investment Company Act Rule 22c-1(a) essentially requires the forward pricing of mutual fund shares. In practice, mutual fund companies usually calculate their NAVs at the close of trading (4:00 p.m. EST). The purpose of the rule is to place all purchasers of mutual fund shares on equal footing as to price and information on any one day. Investors who seek to purchase or redeem mutual fund transactions after the close of trading at the NAV calculated for the same trading day gain the possibility of an information advantage based on after-close news that could affect the mutual fund's holdings but is not reflected in the NAV pricing for that day.

Member firms and their associated persons that knowingly or recklessly effect or facilitate an after-close mutual fund purchase or redemption at the same day's NAV (late trading) violate NASD Rule 2110, which requires the observance of just and equitable principles of trade. Such conduct may also be violative of the federal securities laws and NASD Rule 2120. Late trading is not excused or mitigated as a result of the consent or acquiescence of a mutual fund company, mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person.

Member firms executing mutual fund purchases and redemptions must have and implement policies and procedures reasonably designed to detect and prevent the occurrence of late trading. Member firms should pay particular attention to policies and practices regarding the entry of trades time stamped before or at the close but entered or executed after the close.<sup>2</sup> Similarly, members should take steps reasonably designed to ensure that their systems to correct errors after the close cannot be subverted for the purposes of effecting late trading.

In addition, member firms and their associated persons who knowingly or recklessly undertake, effect, or otherwise facilitate transactions in conjunction with, or with the acquiescence of, a mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person where these other parties would have acted contrary to a representation made in the prospectus or statement of additional information (SAI) pursuant to which the mutual fund shares are offered violate NASD Rule 2110 and may be found to have violated the federal securities laws and NASD Rule 2120.

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For example, certain mutual fund companies represent in their prospectuses or SAs that they engage in practices that are intended to prevent or control market timing transactions. Market timing transactions include mutual fund trades that occur when the purchaser or seller believes that the mutual fund's NAV does not fully reflect the value of the fund's holdings – for example, when the fund has in its portfolio particular holdings, such as foreign or thinly traded securities, which are priced on a basis that does not include the most updated information possible. In order to retard the efforts of investors who seek to profit on these pricing inefficiencies by executing mutual fund trades on a day when the NAV likely will not fully reflect the value of a fund's holdings and realizing the profit by trading the next day, some mutual fund companies have implemented measures to counteract the efforts of timers and have represented in their prospectuses or SAs that they are conducting these measures. Consequently, where the mutual fund company and/or its affiliated persons have represented that they have taken steps to protect investors from market timers, a member firm and its associated persons may not knowingly or recklessly act in conjunction with, or with the acquiescence of, the fund and/or its affiliated persons to undertake, effect, or facilitate a market timing transaction. Again, members must have in place policies and procedures reasonably designed to detect and prevent this collusion with mutual funds and their affiliated persons to circumvent the mutual funds stated procedures.

Members must review the adequacy of their policies and practices with regard to the matters discussed in this *Notice to Members*. NASD intends to examine for reasonable policies and practices with regard to these matters.

## Endnotes

- 1 As used in the this *Notice to Members*, the term "affiliated person" is as defined under Section 2(a)(3) of the Investment Company Act of 1940.
- 2 There may be situations where member firms legitimately receive orders prior to or at the close of trading but enter such orders after market's close. However, members bear the burden of demonstrating that they have implemented policies and procedures that are reasonably designed to prevent the occurrence of late trading.

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# Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Article VIII NASD Regulation By-Laws  
District Committees  
District Nominating Committees

INFORMATIONAL

## District Committees and District Nominating Committees

Amendments to Article VIII of the By-Laws of NASD Regulation, Inc., Regarding District Committees and District Nominating Committees

### Executive Summary

On March 21, 2003, NASD filed with the Securities and Exchange Commission (SEC) a proposed rule change to amend Article VIII of the By-Laws of NASD Regulation, Inc. (By-Laws), to streamline the nomination and election processes governing District Committees and District Nominating Committees (collectively, the Committees), modernize communication procedures, and improve consistency among the Committees across all Districts.<sup>1</sup> The filing was designated as a “non-controversial” rule change and by its terms would have become operative on June 6, 2003. However, to avoid any confusion during this year’s Committee election cycle that was already underway, NASD submitted a subsequent rule filing with the SEC to delay the implementation date of the amendments to January 1, 2004.<sup>2</sup> NASD is conducting this year’s District Committee and District Nominating Committee elections in accordance with the provisions of Article VIII of the By-Laws as in effect prior to the filing of these rule changes.

Article VIII of the By-Laws of NASD Regulation, Inc., as amended, is set forth in [Attachment A](#).

Questions concerning this *Notice* may be directed to Kosha K. Dalal, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-6903.

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## Background and Discussion

Article VIII of the By-Laws sets forth provisions relating to the operation of District Committees and District Nominating Committees, including specifically, provisions regarding Committee meetings, vacancies, and elections. Under Article VIII, the role of the District Committee members includes serving as panelists in disciplinary proceedings in accordance with NASD rules, recommending policy and rule changes to the Board, educating members in their District, and selecting members of the regional District Committee and District Nominating Committees in a manner consistent with Article VIII of the By-Laws. The role of the District Nominating Committee includes nominating candidates to serve on the District Committee and District Nominating Committee for that region.

Currently, there are 11 District Committees, divided by geographic region. Based on the experience of NASD staff in working with the Committees since that time, and the current practices of the Committees, NASD has adopted a series of amendments to modernize and clarify the Article VIII provisions. The amendments are designed to streamline the nomination and election processes by, among other things, centralizing the communication procedures in the Corporate Secretary's Office, revising the nomination and election timeline, and modernizing the methods of communication by permitting electronic delivery of documents. In addition, the amendments will improve coordination and consistency among the Committees across the Districts, modify the procedures to fill vacancies, and provide for more administrative flexibility.

The key amendments are discussed below.

### **Section 8.2 (Composition of District Committees) and Section 8.9 (Composition of District Nominating Committees)**

*Create Consistency in Size of Committee.* To create more consistency in District Committee sizes across Districts, the amendments allow the Board of Directors (Board) to determine the size of each Committee.

*Clarify Qualifications to Serve on Committee.* The amendments clarify the qualifications necessary to serve as a member of a Committee. The amendments provide that a member must: (1) be employed by an NASD member eligible to vote in the District for District Committee elections; and (2) work primarily from such NASD member's principal office or a branch office that is located within the District where the member serves on a Committee. NASD believes this will ensure that local interests are represented on Committees.

*Eliminate Requirement in Section 8.9 that One District Nominating Committee Member be a Current or Former Director or Governor.* The amendments eliminate the requirement that at least one member of the District Nominating Committee be a current or former Director or Governor. Based on the experience of NASD staff, it has become increasingly difficult to satisfy this composition requirement.

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**Section 8.3 (Term of Office of District Committee Member) and Section 8.10 (Term of Office of District Nominating Committee Member)**

*Clarify Term of Office.* The amendments clarify that there is no limit on the number of terms that a Committee member may serve, provided a member may not serve more than two consecutive terms. The word "term" is defined to include either a full term (three years for District Committees or one year for District Nominating Committees) or any partial term where a member is appointed to fill a vacancy. NASD believes that this will allow for greater member participation in the Committees over time.

**Section 8.4 (Filling of Vacancies on District Committee) and Section 8.9 (Filling of Vacancies for District Nominating Committees)**

*Streamline Process for Filling Vacancies.* The amendments clarify that Committee members may formally resign from their positions by serving a notice to the Chair. In addition, the amendments provide a process for filling vacancies. Under the amendments, the Executive Vice President, Regulatory Policy and Programs, the Executive Vice President, Member Regulation, or their respective designee(s) are authorized to determine whether a vacancy created on the Committee needs to be filled. In some instances there may not be a need to fill a vacancy immediately – for example, when there is no scheduled meeting between the time of the vacancy and the next regularly scheduled election. If a determination is made to fill a vacancy or where a new position is created by an increase in Committee size, the Committee would fill such vacancy by a majority vote of a quorum present at a meeting in accordance with the provisions of Sections 8.4 (District Committee) and 8.11 (District Nominating Committee).

**Section 8.5 (Meetings of District Committee) and Section 8.12 (Meetings of District Nominating Committees)**

*Coordinate Procedures for Meetings.* To simplify and better coordinate Committee meetings across Districts, the amendments authorize the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) to determine the times, places, and procedures for Committee meetings in consultation with the Chair of each Committee. In addition, the amendments clarify that an individual may attend a meeting either in person or by telephone and that action taken by telephonic vote will not require written confirmation.

**Section 8.6 (Election of District Officers) and Section 8.13 (Election of District Nominating Committees)**

*Eliminate Requirement to Designate Function of Committee Officers.* The amendments eliminate the requirement for Committees to prescribe the powers and duties of its elected officers because Committees have not found it necessary to perform this function.

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## Section 8.7 (Advisory Council)

*Members to Advisory Council.* The amendments clarify that the Chair of the Market Regulation Committee of NASD is a member of the Advisory Council to the Board.

## General Amendments to Allow Electronic Communications

The amendments provide that where provisions in Article VIII call for notice and other communications to be given either among Committee members, or between Committees and NASD staff, the requirement may be satisfied by electronic means provided the person entitled to notice consents to receive notice in this manner. Specifically, the amendments define the term "Notice" as used in Article VIII to mean a notice in writing or by electronic transmission.

## General Amendments to Centralize Procedures for Nominations and Elections

In general, the amendments establish a more streamlined and flexible election process, conform the By-Laws text with current practice, and allow the Secretary of NASD to play a more centralized role in the election process. For example, the amendments provide that the Secretary of NASD Regulation perform many of the notification and other communication functions currently performed by other parties, such as notifying NASD members of upcoming elections, requesting submission of candidates, notifying NASD members of the candidates nominated by the District Nominating Committee, notifying NASD members in the event of a contested election, and notifying the Board of election results.

## Effective Date

The rule amendments become effective on January 1, 2004.

## Endnotes

- 1 See Securities Exchange Act Release No. 48015 (June 11, 2003), 68 FR 35926 (June 17, 2003) (Notice of Filing and Immediate Effectiveness of File No. SR-NASD-2003-55 (Amendment No. 3 filed on June 6, 2003)).
- 2 See Securities Exchange Act Release No. 48259 (July 30, 2003), 68 FR 46673 (August 6, 2003) (Notice of Filing and Immediate Effectiveness of File No. SR-NASD-2003-107 (Amendment No. 3 filed on June 6, 2003)).

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

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### ARTICLE VIII

#### DISTRICT COMMITTEES AND DISTRICT NOMINATING COMMITTEES

##### Establishment of Districts

**Sec. 8.1** The Board shall establish boundaries for districts within the United States to assist NASD Regulation in administering its affairs in a manner that is consistent with applicable law, the Restated Certificate of Incorporation, these By-Laws, the Delegation Plan, and the Rules of the Association. The Board may make changes from time to time in the number or boundaries of the districts as it deems necessary or appropriate. The Board shall prescribe such policies and procedures as are necessary or appropriate to address the implementation of a new district configuration in the event of a change in the number or boundaries of the districts.

##### Composition of District Committees

**Sec. 8.2** (a) A district created under Section 8.1 shall elect a District Committee pursuant to this Article. A District Committee shall consist of no fewer than five and no more than 20 members, unless otherwise provided by resolution of the Board. Subject to the limitation set forth in the immediately preceding sentence, the authorized number of members of a District Committee shall be determined from time to time by the Board; provided, however, that no decrease in the authorized number of members of a District Committee shall shorten the term of office of any member thereof. Each District Committee member shall: (1) be employed [in the office of] by an NASD member eligible to vote in the district for District Committee elections, and (2) work primarily from such NASD member's principal office or a branch office that is located within the district where the member serves on a District Committee. [A District Committee shall determine the number of its members to be elected each year.] Members of the District Committees shall serve as panelists in disciplinary proceedings in accordance with the Rules of the Association. The District Committees shall consider and recommend policies and rule changes to the Board. The District Committees shall endeavor[, in such manner as they deem appropriate,] to educate NASD members and other brokers and dealers in their respective districts as to the objects, purposes, and work of the NASD[, and NASD Regulation[, and Nasdaq] in order to foster NASD members' interest and cooperation.

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(b) A member of a District Committee may resign at any time upon giving Notice to the District Director. Any such resignation shall take effect upon receipt of such Notice or at any later time specified therein, provided that notice of resignation at a later date may be made immediately effective at the discretion of the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s). The acceptance of such resignation shall not be necessary to make such resignation effective.

(c) [(b)] In the event of the refusal, failure, neglect, or inability of a member of a District Committee to discharge his or her duties, or for any cause affecting the best interests of NASD Regulation, the sufficiency of which shall be decided by the District Committee, the District Committee may remove the member by the affirmative vote of two-thirds of the members of the District Committee then in office and declare the member's position vacant. The District Committee shall notify the District Committee member of his or her removal within seven days after the vote. [The member's position shall be filled pursuant to Section 8.4.]A member who is removed may submit a written appeal of the removal to the Board within 30 days after the date he or she is notified of the removal. The Board may affirm, reverse, or modify the determination of the District Committee. A vote of a majority of the Directors then in office shall be required to reverse or modify the action of the District Committee.

(d) In the event of a vacancy in a District Committee resulting from death, resignation, removal, or other cause, the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) shall determine whether such vacancy shall be filled prior to the next regularly scheduled election of District Committee members. In the event the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines that a vacancy on a District Committee should be filled, the vacancy shall be filled pursuant to Section 8.4.

#### Term of Office of District Committee Members

**Sec. 8.3** Each regularly elected member of a District Committee shall hold office for a "full term" [of three years] which is the later of three years or until a successor is elected and qualified. Notwithstanding the term of office for a regularly elected member, such member's term shall terminate sooner upon the member's [ , or until]death, resignation, or removal. [A member of a District Committee may not serve more than two consecutive terms.]There is no limit on the number of terms that may be served by a member of a District Committee, provided, that no more than two terms may be served consecutively. The word "term" as used for the purpose of this Section shall mean either a full term for a regularly elected member or a "partial term" which is a term served by a member appointed to fill a vacancy on the District Committee created by the termination of a regularly elected member's office prior to the expiration of the full term.



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### Filling of Vacancies on District Committees

**Sec. 8.4** In the event of a vacancy on a District Committee [caused by the departure of a Committee member] prior to the expiration of the member's term of office, and where the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines, pursuant to Section 8.2(d), that such vacancy should be filled, or in the event of a newly created membership on a District Committee by virtue of an increase in the authorized number of members thereof, the District Committee shall appoint by majority vote a representative of an NASD member eligible pursuant to Section 8.2(a) [to vote in the district ]to fill the vacancy or newly created membership. The appointment by the District Committee shall be effective until the next regularly scheduled election [occurs], and until such member's successor is elected and qualified. Following the next regularly scheduled election, in the event of a vacancy, the newly elected Committee member shall serve only the duration of the departed Committee member's term, and in the event of a newly created membership, the newly elected Committee member shall serve only the duration of the term for such class of membership.

### Meetings of District Committees

**Sec. 8.5** Meetings of a District Committee shall be held at such times and places, upon such notice, and in accordance with such procedures as [each District Committee] the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) in [its] his or her discretion may determine in consultation with the Chair of the District Committee. A quorum of a District Committee shall consist of a majority of its members, and any action taken by a majority present at any meeting at which a quorum is present, except as otherwise provided in these By-Laws, shall constitute the action of the Committee. Any or all members of a District Committee may participate in any such meeting by means of conference telephone or other communications equipment by means of which all participants can communicate with each other, and such participation shall constitute presence in person at the meeting. Action by a District Committee may be taken by consent in writing or by electronic transmission in lieu of a meeting [mail, telephonic, or telegraphic vote], in which case any action taken by a majority of the Committee shall constitute the action of the Committee. [Any action taken by telephonic vote shall be confirmed in writing at a regular meeting of the District Committee.]

### Election of District Officers

**Sec. 8.6** At or following its last regularly scheduled meeting of the calendar year, [Following the annual election of members of the District Committees pursuant to this Article] each District Committee shall elect from its members a Chair and such other officers as it deems necessary for the proper performance of its duties under these By-Laws[, and shall prescribe their powers and duties].

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### Advisory Council

**Sec. 8.7** (a) The Chairs of the District Committees, elected pursuant to Section 8.6, together with the Chair of the Market Regulation Committee shall constitute an Advisory Council to the Board.

(b) The Advisory Council shall be advised of and entitled to attend such meetings of the Board as the Board may designate for such Advisory Council's attendance, and the Board shall designate at least one such meeting annually. The Advisory Council shall not be entitled to vote at meetings of the Board.

### Expenses of District Committees

**Sec. 8.8** Funds to meet the regular expenses of each District Committee shall be provided by the Board, and all such expenses shall be subject to the approval of the Board.

### Composition of District Nominating Committees

**Sec. 8.9** (a) Each district created under Section 8.1 shall elect a District Nominating Committee pursuant to this Article. A District Nominating Committee shall consist of five members, unless the Board by resolution increases a District Nominating Committee to a larger number. Each District Nominating Committee member [of a District Nominating Committee] shall: (1) be employed [in the office of] by an NASD member eligible to vote in the district for District Committee elections, and (2) work primarily from such NASD member's principal office or a branch office that is located within the district where the member serves on a District Nominating Committee, but shall not be a member of the District Committee. A majority of the members of the District Nominating Committee shall include [a majority of] persons who previously have served on a District Committee or who are current or former Directors or current or former Governors of the NASD Board[, and shall include at least one current or former Director or Governor].

(b) A member of a District Nominating Committee may resign at any time upon giving Notice to the District Director. Any such resignation shall take effect upon receipt of such Notice or at any later time specified therein, provided that notice of resignation at a later date may be made immediately effective at the discretion of the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s). The acceptance of such resignation shall not be necessary to make such resignation effective.

(c) [(b)] In the event of the refusal, failure, neglect, or inability of a member of a District Nominating Committee to discharge his or her duties, or for any cause affecting the best interests of NASD Regulation, the sufficiency of which shall be decided by the District Nominating Committee, the District Nominating Committee may remove the member by the affirmative vote of two-thirds of the members of the District Nominating Committee then in office and declare the member's position vacant. [The member's position shall be filled pursuant to Section 8.11.] The District Nominating Committee shall notify the District

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Nominating Committee member of his or her removal within seven days after the vote. A member who is removed may submit a written appeal of the removal to the Board within 30 days after the date he or she is notified in writing of the removal. The Board may affirm, reverse, or modify the determination of the District Nominating Committee. A vote of a majority of the Directors then in office shall be required to reverse or modify the action of the District Nominating Committee.

(d) In the event of a vacancy in a District Nominating Committee resulting from death, resignation, removal, or other cause, the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) shall determine whether such vacancy shall be filled prior to the next regularly scheduled election of District Nominating Committee members. In the event the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines that a vacancy on a District Nominating Committee should be filled, the vacancy shall be filled pursuant to Section 8.11.

#### **Term of Office of District Nominating Committee Members**

**Sec. 8.10** Each regularly elected member of a District Nominating Committee shall hold office for a "full term" [of one year] which is the later of one year [and] or until a successor is elected and qualified. Notwithstanding the term of office for a regularly elected member, such member's term shall terminate sooner upon the member's [, or until] death, resignation, or removal. [A member of a District Nominating Committee may not serve more than two consecutive terms.] There is no limit on the number of terms that may be served by a member of a District Nominating Committee, provided, that no more than two terms may be served consecutively. The word "term" as used for the purpose of this Section shall mean either a full term for a regularly elected member or a "partial term" which is a term served by a member appointed to fill a vacancy on the District Nominating Committee created by the termination of a regularly elected member's office prior to the expiration of the full term.

#### **Filling of Vacancies for District Nominating Committees**

**Sec. 8.11** In the event of a vacancy on a District Nominating Committee [caused by the departure of a Committee member] prior to the expiration of the member's term of office, and where the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines, pursuant to Section 8.9(d), that such vacancy should be filled, or in the event of a newly created membership on a District Nominating Committee by virtue of an increase in the authorized number of members thereof, the District Nominating Committee shall appoint by majority vote a representative of an NASD member eligible pursuant to Section 8.9(a) [to vote in the district ] to fill the vacancy or newly created membership. The appointment shall be effective until the next regularly scheduled election [occurs] pursuant to this Article, and until such member's successor is elected and qualified.

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### Meetings of District Nominating Committees

**Sec. 8.12** Meetings of a District Nominating Committee shall be held at such times and places, upon such notice, and in accordance with such procedures as [each District Nominating Committee] the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) in [its] his or her discretion may determine in consultation with the Chair of the District Nominating Committee. A quorum of a District Nominating Committee shall consist of a majority of its members, and any action taken by a majority [of the entire Committee]present at any meeting at which a quorum is present, except as otherwise provided in these By-Laws, shall constitute the action of the District Nominating Committee. Any or all members of a District Nominating Committee may participate in any such meeting by means of conference telephone or other communications equipment by means of which all participants can communicate with each other, and such participation shall constitute presence in person at the meeting. Action by a District Nominating Committee may be taken by consent in writing or by electronic transmission in lieu of a meeting [mail, telephonic, or telegraphic vote], in which case any action taken by a majority of the District Nominating Committee shall constitute the action of the District Nominating Committee. [Action taken by telephonic vote shall be confirmed in writing at a regular meeting of the District Committee].[]

### Election of District Nominating Committee Officers

**Sec. 8.13** Following the annual election of members of the District Nominating Committees pursuant to this Article, each District Nominating Committee shall elect from its members a Chair and such other officers as it deems necessary for the proper performance of its duties under these By-Laws[, and shall prescribe their powers and duties].

### Expenses of District Nominating Committees

**Sec. 8.14** Funds to meet the regular expenses of each District Nominating Committee shall be provided by the Board, and all such expenses shall be subject to the approval of the Board.

### Notice to [Chair] District Nominating Committee

**Sec. 8.15** On or before [May 1]June 1 of each year, the Secretary of NASD Regulation shall give a Notice [send a written notice] to [the Chair of] each District Nominating Committee member and each District Director [and each District Committee] identifying the members of the District Nominating Committee and the District Committee whose terms of office shall expire in the next calendar year. The Notice [notice] shall describe election procedures for filling the offices.

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### **Solicitation of Candidates and Secretary's Notice to NASD Members**

**Sec. 8.16** The Secretary of NASD Regulation shall give a Notice of the upcoming election to NASD members and the Executive Representatives of NASD members describing the election procedures and stating that NASD members may submit names of candidates for consideration to the District Director. NASD Regulation staff shall provide the District Nominating Committee with a description of the NASD membership in the district. The District Nominating Committee shall identify and solicit candidates to nominate for election to [the vacancies on] the District Committee and the District Nominating Committee. [The District Nominating Committee Chair shall send a written notice of the upcoming election to the Executive Representative and each branch office of the NASD members in the district and request that such NASD members submit names of candidates to the District Nominating Committee or the District Director for consideration.]

#### **[Secretary's Notice to NASD Members]**

[**Sec. 8.17** The Secretary of NASD Regulation shall send a written notice to NASD members in the district describing the election procedures.]

#### **District Nominating Committee Slate**

**Sec. 8.17** [Sec. 8.18] (a) The District Nominating Committee shall review the background of proposed candidates and the description of the NASD membership provided by NASD Regulation staff and shall nominate a slate of candidates for the election. The slate shall include one [or more] candidate[s] for each position on the District Committee and the District Nominating Committee subject to election at the next annual election [vacancy]. In nominating candidates for the office of member of the District Committee and the office of member of the District Nominating Committee, the District Nominating Committee shall endeavor to secure appropriate and fair representation on the District Committee and on the District Nominating Committee of the various sections of the district and [all] various classes and types of NASD members engaged in the investment banking or securities business within the district. In nominating candidates for the office of member of the District Nominating Committee, a District Nominating Committee shall assure that the composition of the District Nominating Committee meets the standards in Section 8.9(a).

(b) A District Nominating Committee shall not nominate an incumbent member of the District Committee to succeed himself or herself on the District Committee [unless the District Nominating Committee first takes appropriate action by a written ballot of the entire NASD membership within the district to ascertain that such nomination is acceptable to a majority of the NASD members in the district,] unless the incumbent member of the District Committee is serving pursuant to the provisions of Section 8.4 or is serving a term pursuant to the provisions of Section 8.2 and reelection would not cause the incumbent member to violate the provisions of Section 8.3. A District Nominating Committee may not nominate more than two incumbent members of the District Nominating Committee to succeed themselves.

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### [Certification] Notification of Nomination

**Sec. 8.18** [Sec. 8.19] The District Director, acting on behalf of the District Nominating Committee, shall give a Notice to the Secretary of NASD Regulation of [certify to the District Committee] each candidate nominated by the District Nominating Committee and the office to which the candidate is nominated. [Within five calendar days after the certification, the District Committee shall send to the Executive Representatives of NASD members in the district a copy of the certification.] On or before October 1 of each year, the Secretary of NASD Regulation shall give a Notice of the nominated candidates to the Executive Representatives of NASD members and the District Committee.

### Uncontested Election

**Sec. 8.19** If the District Nominating Committee nominates one candidate for each position on the District Committee and the District Nominating Committee subject to election at the next annual election and no additional candidate is nominated pursuant to Section 8.22, the candidates nominated by the District Nominating Committee shall be considered duly elected.

### Designation of Additional Candidates

**Sec. 8.20** If an officer, director, or employee of an NASD member who meets the qualifications of Section 8.2 or 8.9, as applicable, is not nominated by the District Nominating Committee and wants to be considered for election to [a vacancy on] the District Committee or the District Nominating Committee, he or she shall deliver [send] a written notice to the District Director within 14 calendar days after the Secretary of NASD Regulation gives the Notice of nominated candidates [the mailing date of the certification to the Executive Representatives] pursuant to Section 8.18[9]. The District Director shall make a written record of the time and date of the receipt of the officer's, director's, or employee's notice. The officer, director, or employee shall be designated as an "additional candidate."

### List of NASD Members Eligible to Vote

**Sec. 8.21** (a) The Secretary of NASD Regulation shall provide a list of all NASD members eligible to vote in the district, their mailing addresses, and their Executive Representatives to the additional candidate promptly [immediately] following receipt of the additional candidate's timely notice by the District Director.

(b) An NASD member that has its principal office[,] and/or one or more registered branch offices[, or its principal office and one or more registered branch offices] in the district shall be eligible to cast one vote through the NASD member's Executive Representative for each position on the District Committee and the District Nominating Committee [vacancy] to be filled in the election.

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### Requirement for Petition Supporting Additional Candidate

**Sec. 8.22** An additional candidate shall be nominated if a petition signed by at least ten percent of the NASD members eligible to vote in the district is filed with the District Nominating Committee within 30 calendar days after the date of the mailing of the list to the additional candidate pursuant to Section 8.21. Only an Executive Representative may sign a petition on behalf of an NASD member.

#### [Uncontested Election]

[**Sec. 8.23** If the District Nominating Committee nominates one candidate for each vacancy and no additional candidate is nominated pursuant to Section 8.22, the candidates nominated by the District Nominating Committee shall be considered duly elected and the District Committee shall certify the election to the Board.]

#### Notice of Contested Election

**Sec. 8.23** [Sec. 8.24] If [the District Nominating Committee nominates more than one candidate for vacancy, or if] an additional candidate is nominated pursuant to Section 8.22, the election shall be considered a contested election. The Secretary of NASD Regulation shall give a Notice [District Committee shall send a notice] to the Executive Representatives of the NASD members eligible to vote in the district announcing the names of the candidates and the office to which each candidate is nominated and describing contested election procedures.

#### Administrative Support

**Sec. 8.24** [Sec. 8.25] The District Office shall provide administrative support to all candidates by sending, by electronic transmission, to NASD members eligible to vote in the district up to two distributions [mailings] of materials prepared by the candidates. [NASD Regulation shall pay the postage for the mailings.] If a candidate wants such distributions [mailings] sent, the candidate shall prepare such material on the candidate's personal stationery and make the material available to NASD Regulation in electronic format. The material shall state that it represents the opinion of the candidate. [The candidate shall provide a copy of the material for each member of the NASD in the district.] Candidates nominated by the District Nominating Committee may identify themselves as such in their materials. Any candidate also may send [additional] mailings at the candidate's own expense. Except as provided in this Article, NASD Regulation, the Board, the Regional Nominating Committee, any other committee, and NASD Regulation staff shall not provide any other administrative support to a candidate in the election.

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## Ballots

**Sec. 8.25** [Sec. 8.26] With the assistance of the Secretary of NASD Regulation and an Independent Agent, the District Nominating Committee shall prepare a ballot with the names of the District Nominating Committee's candidates and any additional candidate nominated pursuant to Section 8.22 and the office to which each candidate is nominated. The ballot shall list separately, in alphabetical order, the candidates [in alphabetical order and shall identify the candidates] nominated by the District Nominating Committee and the additional candidates nominated pursuant to Section 8.22. The Secretary of NASD Regulation [District Nominating Committee] shall send a ballot to the Executive Representative of each NASD member eligible to vote in the district. Instructions on the ballot shall direct the Executive Representative to return the ballot to the Independent Agent and state that the ballot envelope must be postmarked on or before the return date specified on the ballot. The return date specified on the ballot shall be no fewer than [30]20 and no more than [45]30 days after the date of mailing of the ballot.

## Vote Qualification List

**Sec. 8.26** [Sec. 8.27] Eligibility to vote in a district election shall be based on the NASD's membership records as of a date selected by the Secretary of NASD Regulation that is not more than 30 days before the date of mailing of the ballot. The Secretary of NASD Regulation shall prepare a list of NASD members eligible to vote in the district, their mailing addresses, and their Executive Representatives, which shall be used for vote qualification purposes, and shall provide the list to the candidates.

## Ballots Returned as Undelivered

**Sec. 8.27** [Sec. 8.28] The Independent Agent shall open any ballot envelope returned undelivered and shall determine whether it was sent to the NASD member's address of record. If incorrectly addressed, the Independent Agent shall send a new ballot to the address of record.

## General Procedures for Qualification and Accounting of Ballots

**Sec. 8.28** [Sec. 8.29] After the voting period, on a date or dates designated by the Secretary of NASD Regulation, the qualification and accounting of ballots shall take place. The date or dates designated shall be not later than 14 calendar days after the return date specified on the ballot pursuant to Section 8.25[6]. Candidates and their representatives shall be allowed to observe the qualification and accounting of ballots. Representation for each candidate shall be limited to two individuals. The Independent Agent shall bring to [the district office] a location within the district agreed to between the Independent Agent and the Secretary of NASD Regulation all ballots timely received. Under the direction of the Secretary of NASD Regulation or the Secretary's designee, the Independent Agent shall open and count the ballots. For ballot qualification purposes, the Independent Agent shall identify to the candidates the NASD members that timely returned ballots and inform the candidates of the Independent Agent's determination of whether or not a ballot is qualified for voting purposes.



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The determination shall be based on a comparison of ballots received against the list of NASD members eligible to vote in the district and their Executive Representatives as prepared by the Secretary of NASD Regulation pursuant to Section 8.26[7]. The Secretary of NASD Regulation or the Secretary's designee shall make the final determination of the qualification of a ballot. Upon the qualification of a ballot, the Independent Agent shall record the vote indicated on the ballot. The candidates and their representatives shall not be allowed to see the vote of an NASD member.

### Ballots Set Aside

**Sec. 8.29** [Sec. 8.30] The Independent Agent shall set aside a ballot if: (a) the ballot is received from an NASD member eligible to vote in the district and the ballot is signed by a person who is not the Executive Representative listed on the vote qualification list prepared under Section 8.26[7], and the Secretary of the NASD has not received proper notice of a change in Executive Representative pursuant to the NASD By-Laws; or (b) if two or more properly executed ballots are received from an NASD member eligible to vote in the district. If the Independent Agent determines that the ballots set aside are material to the outcome of the election, the Secretary of NASD Regulation and the Independent Agent shall make reasonable efforts to resolve each ballot set aside. With respect to a ballot not signed by an Executive Representative of record, the Secretary of NASD Regulation shall contact the NASD member to request that the NASD member send written notice of any change in Executive Representative by facsimile so that the ballot may be counted. With respect to multiple ballots from an NASD member, the Independent Agent shall contact the Executive Representative of the NASD member to obtain the NASD member's vote. The Secretary of NASD Regulation shall keep a list of NASD members that reported their ballot was lost or not received and that were provided with a duplicate ballot. The Secretary of NASD Regulation shall provide the list to the Independent Agent and, upon request, to the candidates.

### Invalid Ballots

**Sec. 8.30** [Sec. 8.31] The Independent Agent shall declare a ballot invalid if one or more of the following conditions exist:

- (a) the ballot is not signed by the Executive Representative (unless Section 8.29[30] applies);
- (b) a vote is not indicated on the ballot; or
- (c) the ballot indicates votes for more candidates than there are positions on the District Committee or District Nominating Committee subject to election in the election [vacancies for an office].

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### [Certification of] Election Results

**Sec. 8.31** [Sec. 8.32] Under the direction of the Secretary of NASD Regulation or the Secretary's designee, the Independent Agent shall count the votes received for each candidate in a district. The candidates for the office of member of the District Committee or District Nominating Committee receiving the largest number of votes cast in the district for the office shall be declared elected such that the number of candidates declared elected equals the number of positions [vacancies] on the District Committee or District Nominating Committee subject to election in the election. [The candidates for the office of member of the District Nominating Committee receiving the largest number of votes cast in the district for the office shall be declared elected such that the number of candidates declared elected equals the number of vacancies on the District Nominating Committee.] In the event of a tie, there shall be a run-off election. The Secretary of NASD Regulation shall notify the Board of the election results. [Each District Committee shall send a written certification of the election results to the Board.] The notification [certification] shall state the number of votes received by each candidate and the number of ballots set aside.

### Extensions of Time and Additional Procedures

**Sec. 8.32** [Sec. 8.33] The Secretary of NASD Regulation may extend a time period under this Article for good cause shown. In extraordinary circumstances, the Secretary of NASD Regulation, with the approval of the Executive Committee or the Board, may adopt additional procedures for elections under this Article.

### Definitions

**Sec. 8.33** (a) When used in Article VIII of these By-Laws, the term "Notice" means a notice in writing or by electronic transmission and the term "electronic transmission" means any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved and reviewed by a recipient thereof, and that may be directly reproduced in paper form by such a recipient through an automated process.

(b) For purposes of this Article VIII, any notice by NASD Regulation, the Secretary of NASD Regulation, or the District Director given by electronic transmission shall be deemed given: (1) if by facsimile telecommunication, when directed to a number at which the person entitled to notice has consented to receive notice; (2) if by electronic mail, when directed to an electronic mail address at which the person entitled to notice has consented to receive notice; (3) if by a posting on an electronic network when the person entitled to notice has consented to receive notice in this manner, together with separate notice to the person entitled to notice of such specific posting, upon the later of (A) such posting and (B) the giving of such separate notice; and (4) if by any other form of electronic transmission when the person entitled to notice has consented to receive notice in this manner, when directed to the person entitled to notice. For purposes of this Article VIII, if mailed, any such notice by NASD Regulation, the Secretary of NASD Regulation, or the District Director shall be deemed given when deposited in the United States mail, postage prepaid, directed to the person entitled to notice at such person's address as it appears on the records of NASD Regulation.

# Special Notice to Members

SEPTEMBER 2003

INFORMATIONAL

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registration  
Senior Management

## KEY TOPICS

District Elections

## District Elections

Nominees for District Committee and District Nominating Committee

### Executive Summary

The purpose of this *Special Notice to Members* is to announce the nominees for the District Committees and the District Nominating Committees. The individuals identified in this *Special Notice to Members* (see Attachment A) have been nominated for three-year terms<sup>1</sup> on the District Committees and for one-year terms on the District Nominating Committees starting in January 2004. These nominees will be considered duly elected on **October 1, 2003**, unless an election is contested in accordance with the procedures summarized below.

We appreciate the interest shown by many of you in participating in the District Committees and thank everyone for their continuing support of the self-regulatory process. We look forward to your participation in the matters of the Districts during the coming year, as well as hope that those who were not selected this year may wish to revisit this process next year.

### Contested Election Procedures

If an officer, director, or employee of a NASD member is interested in being considered as an additional candidate, he/she must indicate his/her interest to the District Director, or the Corporate Secretary, Barbara Z. Sweeney, by **October 1, 2003**. If an additional candidate(s) comes forward by that date, the candidate has until **October 31, 2003**, to submit a petition to the District Nominating Committee with signatures from at least 10 percent of Executive Representatives of members eligible to vote in the District.

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If no additional candidates submit petitions by **October 31, 2003**, then the candidates nominated by the District Nominating Committee shall be considered elected as of **October 1, 2003**, and the District Committee shall certify the election to the Board of Directors of NASD Regulation.

Additional information pertaining to the District Election Procedures can be found in Article VIII of the By-Laws of NASD Regulation.

### Questions/Further Information

Questions concerning this *Special Notice* may be directed to the District Director noted in Attachment A or to Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, at (202) 728-8062 or via e-mail at: [barbara.sweeney@nasd.com](mailto:barbara.sweeney@nasd.com).

### Endnote

- 1 Some nominees are filling existing vacancies and therefore may serve less than a three-year term, as indicated on Attachment A.

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## ATTACHMENT A

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### District Committee and District Nominating Committee Nominees

#### District 1

**Elisabeth P. Owens**, District Director

525 Market Street, Suite 300, San Francisco, CA 94105-2711

(415) 882-1200

*Northern California (the counties of Monterey, San Benito, Fresno, and Inyo, and the remainder of the state north or west of such counties), northern Nevada (the counties of Esmeralda and Nye, and the remainder of the state north or west of such counties), and Hawaii*

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#### 2003 District Nominating Committee Chair

Glenn M. Colacurci	Salomon Smith Barney	San Francisco, CA
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#### District 1 Nominees

William A. Evans	Stone & Youngberg LLC	San Francisco, CA
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Mansoor Kisat	Citigroup Global Markets, Inc.	Santa Rosa, CA
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Arthur E. Raitano	Hoefler & Arnett, Incorporated	San Francisco, CA
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#### District 1 Nominating Committee Nominees

Stephen R. Adams	Wells Fargo Investments, LLC	San Francisco, CA
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Sally G. Aelion	Emmett A. Larkin Company, Inc.	San Francisco, CA
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Robert S. Basso	Correspondent Services Corporation	San Francisco, CA
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James D. Klein	UBS PaineWebber, Inc.	San Francisco, CA
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L. Robert McKulla	Prudential Division of Wachovia Securities, LLC	Walnut Creek, CA
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## District Committee And District Nominating Committee Nominees

### District 2

**Lani M. Sen Woltmann**, District Director

300 South Grand Avenue, Suite 1600, Los Angeles, CA 90071

(213) 627-2122

*Southern California (that part of the state south or east of the counties of Monterey, San Benito, Fresno, and Inyo), southern Nevada (that part of the state south or east of the counties of Esmeralda and Nye), and the former U.S. Trust Territories*

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### 2003 District Nominating Committee Chair

Robert L. Winston	American Funds Distributors, Inc.	Los Angeles, CA
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### District 2 Nominees

Stephen B. Benton	Financial Network Investment Corp.	Torrance, CA
James M. S. Dillahunty	Fixed Income Securities, LLC	San Diego, CA
John D. Lewis	JDL Securities Corp.	Newport Beach, CA

### District 2 Nominating Committee Nominees

James E. Biddle	The Securities Center Incorporated	Chula Vista, CA
Margaret M. Black	Morgan Stanley Dean Witter	Los Angeles, CA
Diane P. Blakeslee	Blakeslee & Blakeslee, Inc.	San Luis Obispo, CA
Miles Z. Gordon		Indian Wells, CA
Steven K. McGinnis	Keystone Capital Corporation	San Diego, CA

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## District Committee And District Nominating Committee Nominees

### District 3

**Joseph M. McCarthy**, District Director

370 17th Street, Suite 2900, Denver, CO 80202-5629

(303) 446-3100

*Arizona, Colorado, New Mexico, Utah, and Wyoming*

**James G. Dawson**, District Director

Two Union Square, 601 Union Street, Suite 1616, Seattle, WA 98101-2327

(206) 624-0790

*Alaska, Idaho, Montana, Oregon, and Washington*

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### 2003 District Nominating Committee Chair

Martin O. Nelson                      Martin Nelson & Co., Inc.                      Seattle, WA

### District 3 Nominees

Curtis J. Hammond	Morgan Stanley Dean Witter, Inc.	Bellevue, WA
J. Keith Kessel	AFS Brokerage, Inc.	Greenwood Village, CO
Arlene M. Wilson	D.A. Davidson & Co.	Great Falls, MT

### District 3 Nominating Committee Nominees

Elyssa S. Baltazar	Morgan Stanley Dean Witter, Inc.	Denver, CO
L. Hoyt DeMers	Wells Fargo Investments, LLC	Seattle, WA
Steven Larson	Richards Merrill & Peterson Inc.	Spokane, WA
Anthony B. Petrelli	Neidiger, Tucker, Bruner, Inc.	Denver, CO
Kathryn A. Supko	Northwestern Mutual Investment Services, LLC	Boise, ID

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## District Committee And District Nominating Committee Nominees

### District 4

**Thomas D. Clough**, District Director

120 West 12th Street, Suite 900, Kansas City, MO 64105

(816) 421-5700

*Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota*

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### 2003 District Nominating Committee Chair

Norman Frager	Flagstone Securities, LLC	St. Louis, MO
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### District 4 Nominees

Michael D. Burns (2-Year Term)	USAllianz Securities, Inc.	Minneapolis, MN
Joseph D. Fleming	U.S. Bancorp Piper Jaffray, Inc.	Minneapolis, MN
Richard M. Hurwitz	Benefit Finance Securities, LLC	St. Louis, MO
Mark T. Lasswell	Wells Fargo Brokerage Services, LLC	Minneapolis, MN
Kevin P. Maas (2-Year Term)	PrimeVest Financial Services, Inc.	St. Cloud, MN

### District 4 Nominating Committee Nominees

Gene M. Diederich	A.G. Edwards & Sons, Inc.	Overland Park, KS
Timothy J. Lyle	Trusted Securities Advisors Corp.	Minneapolis, MN
E. John Moloney	Moloney Securities Co., Inc.	St. Louis, MO
L.C. (Jack) Petersen	Kirkpatrick, Pettis, Smith, Polian, Inc.	Omaha, NE
Pamela R. Ziermann	Dougherty & Company, LLC	Minneapolis, MN



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## District Committee And District Nominating Committee Nominees

### District 5

**Warren A. Butler, Jr.,** District Director

1100 Poydras Street, Energy Centre, Suite 850, New Orleans, LA 70163-0802

(504) 522-6527

*Alabama, Arkansas, Louisiana, Mississippi, Oklahoma, and Tennessee*

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### 2003 District Nominating Committee Chair

Duncan F. Williams	Duncan-Williams, Inc.	Memphis, TN
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### District 5 Nominees

Jennifer Carty Scola	Carty & Company, Inc.	Memphis, TN
R. Patrick Shepherd	Avondale Partners, L.L.C.	Nashville, TN
Donald R. Winton	Crews & Associates, Inc.	Little Rock, AR

### District 5 Nominating Committee Nominees

David A. Daugherty	James Baker & Associates	Oklahoma City, OK
James S. Holbrook, Jr.	Sterne, Agee & Leach, Inc.	Birmingham, AL
E. Douglas Johnson, Jr.	Johnson Rice & Company L.L.C.	New Orleans, LA
Tom R. Steele	Equitable Advisors, Inc.	Nashville, TN
Duncan F. Williams	Duncan-Williams, Inc.	Memphis, TN

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## District Committee And District Nominating Committee Nominees

### District 6

**Virginia F. M. Jans**, District Director

12801 N. Central Expressway, Suite 1050, Dallas, TX 75243

(972) 701-8554

Texas

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### 2003 District Nominating Committee Chair

Fredrick W. McGinnis	UBS PaineWebber, Inc.	Houston, TX
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### District 6 Nominees

Karen Banks	Frost Brokerage Services, Inc.	San Antonio, TX
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Cynthia E. Besek	Maplewood Investment Advisors, Inc.	Dallas, TX
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Darryl W. Traweek	RBC Dain Rauscher Inc.	Houston, TX
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### District 6 Nominating Committee Nominees

Christopher R. Allison	M.E. Allison & Co., Inc.	San Antonio, TX
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C. Ronald Baker	The (Wilson) Williams Financial Group	Lubbock, TX
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William B. Madden	Madden Securities Corporation	Dallas, TX
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Edward M. Milkie	Milkie/Ferguson Investments, Inc.	Dallas, TX
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David W. Turner	Wachovia Securities, Inc.	Fort Worth, TX
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## District Committee And District Nominating Committee Nominees

### District 7

**Alan M. Wolper**, District Director

One Securities Centre, Suite 500, 3490 Piedmont Road, NE, Atlanta, GA 30305

(404) 239-6100

*Florida, Georgia, North Carolina, South Carolina, Puerto Rico, the Canal Zone, and the Virgin Islands*

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### 2003 District Nominating Committee Chair

Edward R. Hipp, III	Legg Mason Wood Walker, Inc.	Norfolk, VA
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### District 7 Nominees

Susan J. Hechtlinger	Banc of America Investment Services, Inc.	Charlotte, NC
Landrum H. Henderson, Jr.	Legg Mason Wood Walker, Inc.	Charlotte, NC
Alan L. Maxwell, Jr.	Wachovia Capital Markets, LLC	Charlotte, NC
Mr. Roark A. Young (One-Year Term)	Young, Stovall and Company	Miami, FL

### District 7 Nominating Committee Nominees

Michael D. Hearn, Esq.	Banc of America Investment Services, Inc.	Charlotte, NC
Kenneth W. McGrath	Popular Securities, Inc.	Hato Rey, PR
C. John O'Bryant, III	PowellJohnson, Private Asset Management	Raleigh, NC
Glenn R. Oxner	Scott & Stringfellow, Inc.	Greenville, SC
John W. Waechter	William R. Hough & Co.	St. Petersburg, FL

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## District Committee And District Nominating Committee Nominees

### District 8

**Carlotta A. Romano**, District Director

55 West Monroe Street, Suite 2700, Chicago, IL 60603-5051

(312) 899-4400

*Illinois, Indiana, Kentucky, Michigan, and Wisconsin*

**William H. Jackson, Jr.**, District Director

Renaissance on Playhouse Square, 1350 Euclid Avenue, Suite 650, Cleveland, OH 44115

(216) 592-2950

*Ohio*

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### 2003 District Nominating Committee Chair

Wallen L. Crane	Salomon Smith Barney	Toledo, OH
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### District 8 Nominees

Michael E. Bosway	City Securities Corporation	Indianapolis, IN
Robert J. Michelotti	Ferris, Baker Watts Incorporated	Auburn Hills, MI
Lora Rosenbaum	Northwestern Mutual Investment Services	Milwaukee, WI

### District 8 Nominating Committee Nominees

William C. Alsover, Jr.	Centennial Securities Company, Inc.	Grand Rapids, MI
Mary D. Esser	Cressman Esser Securities, Inc.	Naperville, IL
Gregory Goelzer	Goelzer Investment Management	Indianapolis, IN
Rodney Trautvetter	Harris Investor Services, LLC	Chicago, IL
Bruce J. Young	Mesirow Financial, Inc.	Chicago, IL

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## District Committee And District Nominating Committee Nominees

### District 9

**Gary K. Liebowitz**, District Director

581 Main Street, 7th Floor, Woodbridge, NJ 07905

(732) 596-2000

*New Jersey and New York (except for the Counties of Nassau, Orange, Putnam, Rockland, Suffolk, Westchester, and the five boroughs of New York City)*

**John P. Nocella**, District Director

Eleven Penn Center, 1835 Market Street, Suite 1900, Philadelphia, PA 19103

(215) 665-1180

*Delaware, the District of Columbia, Maryland, Pennsylvania, Virginia and West Virginia*

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### 2003 District Nominating Committee Chair

A. Louis Denton	Philadelphia Corporation for Investment Services	Philadelphia, PA
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### District 9 Nominees

John Blucher	Knight Securities, L.P.	Jersey City, NJ
Barry M. Cash	UBS Financial Services, Inc.	Fishkill, NY
Peter P. Jenkins	Credit Suisse First Boston LLC	Baltimore, MD

### District 9 Nominating Committee Nominees

J. Lee Keiger, III	Davenport & Company, LLC	Richmond, VA
John P. Meegan	Parker/Hunter Incorporated	Pittsburgh, PA
Lance A. Reihl	1717 Capital Management Company	Berwyn, PA
Howard B. Scherer	Janney Montgomery Scott LLC	Philadelphia, PA
Lenda P. Washington	GRW Capital Corporation	Washington, DC

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## District Committee And District Nominating Committee Nominees

### District 10

**Robert B. Kaplan**, Acting District Director

One Liberty Plaza, New York, NY 10006

(212) 858-4000

*The five boroughs of New York City, and Long Island*

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### 2003 District Nominating Committee Chair

Tom M. Wirtshafter	AXA Advisors, LLC	New York, NY
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### District 10 Nominees

Richard Berenger	MetLife Securities, Inc.	New York, NY
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Lon T. Dolber	American Portfolios Financial Services	Holbrook, NY
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George T. Mimura	Nomura Securities International, Inc.	New York, NY
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Howard R. Plotkin	Lehman Brothers Inc.	New York, NY
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### District 10 Nominating Committee Nominees

William Behrens	Northeast Securities, Inc.	New York, NY
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Ruth S. Goodstein	UBS Financial Services, Inc.	New York, NY
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Judith R. MacDonald	Rothschild, Inc.	New York, NY
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Charles V. Senatore	Fidelity Brokerage Services, LLC	New York, NY
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Stephen C. Strombelline	BNP Paribas Securities Corp.	New York, NY
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## District Committee And District Nominating Committee Nominees

### District 11

**Frederick F. McDonald**, District Director

260 Franklin Street, 16th Floor, Boston, MA 02110

(617) 261-0800

*Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont*

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### 2003 District Nominating Committee Chair

**Stephen O. Buff**                      Fleet Securities, Inc.                      Boston, MA

### District 11 Nominees

**David K. Booth**                      Jefferson Pilot Securities Corp.                      Concord, NH

**Thomas F. Hollenbeck**                      J.P. Morgan Invest, LLC                      Boston, MA

**Curtis L. Snyder, Jr.**                      American Technology Research, Inc.                      Old Greenwich, CT

### District 11 Nominating Committee Nominees

**Richard J. DeAgazio**                      Boston Capital Services, Inc.                      Boston, MA

**John I. Fitzgerald**                      Leerink Swann & Company                      Boston, MA

**John D. Lane**                      Lane Capital Markets LLC                      Fairfield, CT

**Robert V. Rodia**                      People's Securities, Inc.                      Bridgeport, CT

**Gregory D. Teese**                      Equity Services, Inc.                      Montpelier, VT

# Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Rule 2710  
Rule 2810  
Non-Cash Compensation Provisions  
Rule Modernization

INFORMATIONAL

## Non-Cash Compensation

SEC Announces Immediate Effectiveness of Amendments to Non-Cash Compensation Provisions of Rule 2710 and Rule 2810

### Executive Summary

On April 7, 2003, NASD filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a proposed rule change to codify existing staff interpretations regarding the non-cash compensation provisions in Rule 2710 (Corporate Financing Rule) and Rule 2810 (Direct Participation Program or DPP Rule) and to make the rule text in such Rules consistent with the non-cash compensation provisions in Rule 2820 (Variable Contracts Rule) and Rule 2830 (Investment Company Rule).<sup>1</sup> The rule change has become effective as of April 7, 2003.

Rule 2710 and Rule 2810, as amended, are set forth in Attachment A.

Questions concerning this *Notice* may be directed to Therese M. Woods, Deputy Director, Corporate Financing Department, NASD, at (240) 386-4661; or Kosha K. Dalal, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-6903.

### Background and Discussion

Since 1994, the SEC, NASD, and the securities industry have raised concerns about actual and potential conflicts of interest in the retail brokerage business created by a broad range of compensation practices whereby program sponsors or issuers provide incentives or rewards to individual broker/dealers and their registered representatives for selling the issuer's products. NASD staff believes that the use of non-cash compensation can create significant point-of-sale incentives that may compromise suitability determinations



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and heighten the potential for loss of supervisory control over sales practices. In addition, NASD staff believes that the use of non-cash compensation incentives may result in the loss of investor confidence by increasing the perception of inappropriate practices.

Responding to these concerns, in January 1999 NASD amended the Variable Contracts and Investment Company Rules to establish comprehensive restrictions on the use of non-cash compensation in connection with the sale and distribution of investment company securities and variable contracts.<sup>2</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."

Since January 1999, through interpretive advice, responses to exemptive requests, and in the course of the filing review process under the Corporate Financing and DPP Rules, NASD staff has consistently applied the non-cash compensation prohibitions in the Variable Contracts and Investment Company Rules to sales of variable annuities, mutual funds, DPP securities, public offerings of debt and equity securities, and real estate investment trust (REIT) programs. Although training and education meetings were not permitted under the original non-cash compensation provisions of the Corporate Financing and DPP Rules, NASD has recognized that *bona-fide* training and education meetings that meet the strict requirements set out in the Variable Contracts and Investment Company Rules can be held consistent with the non-cash compensation prohibitions.

The amendments to the Corporate Financing and DPP Rules codify a stated policy, practice, and interpretation that the more detailed non-cash compensation provisions in the Variable Contracts and Investment Company Rules apply to the sale and distribution of securities governed by the Corporate Financing and DPP Rules. NASD is conforming the language in the Corporate Financing and DPP Rules to be consistent with the more detailed language contained in the Variable Contracts and Investment Company Rules by: (1) adopting definitions of the terms "compensation," "non-cash compensation" and "offeror"; (2) providing express exceptions from the non-cash compensation limitations for *bona-fide* training and education meetings; and (3) prohibiting, 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, REIT programs, or DPP securities.

Consistent with the Variable Contracts and Investment Company Rules, the rule amendments 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

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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.

The amendments to the Corporate Financing and DPP Rules codify the application of the training and education meetings exception, and corresponding interpretive guidance, to the sale and distribution of public offerings of debt and equity securities, REIT programs, and DPPs. Currently, the Variable Contracts and Investment Company Rules 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 two rules, however, contain conditions that must be satisfied before the exception can be used. Specifically, they require the following: receipt of 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 appropriate and meet certain requirements;<sup>3</sup> and that no reimbursement be provided for expenses of a guest. Since the adoption of these provisions, 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 connection with a training and education meeting, including, but not limited to, golf outings, cruises, tours, and other entertainment.

### Effective Date

The rule amendments were effective immediately upon filing with the Commission, which was April 7, 2003.

### Endnotes

- 1 See Securities Exchange Act Release No. 47697 (April 18, 2003), 68 FR 20191 (April 24, 2003) (Notice of Filing and Immediate Effectiveness of File No. SR-NASD-2003-68 (April 7, 2003)).
- 2 See Securities Exchange Act Release No. 40214 (July 15, 1998), 63 FR 39614 (July 23, 1998), File No. SR-NASD-97-35 (May 7, 1997).
3. The non-cash compensation provisions specify that the location of a training and education meeting must be appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

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### 2710. Corporate Financing Rule – Underwriting Terms and Arrangements

(a) through (b) No Change.

#### (c) Underwriting Compensation and Arrangements

(1) through (5) No Change.

#### (6) Unreasonable Terms and Arrangements

(A) No Change.

(B) Without limiting the foregoing, the following terms and arrangements, when proposed in connection with the distribution of a public offering of securities, shall be unfair and unreasonable:

(i) through (xii) No Change.

(xiii) [for a member or person associated with a member to accept, directly or indirectly, any non-cash sales incentive item including, but not limited to, travel bonuses, prizes and awards, from an issuer or an affiliate thereof in excess of \$100 per person per issuer annually. Notwithstanding the foregoing, a member may provide non-cash sales incentive items to its associated persons provided that no issuer, or an affiliate thereof, including specifically an affiliate of the member, directly or indirectly participates in or contributes to providing such non-cash sales incentive; or]

(xiv) – (xv) Renumbered (xiii) – (xiv).

(7) through (8) No Change.

#### (d) Non-Cash Compensation

##### (1) Definitions

The terms “compensation,” “non-cash compensation” and “offeror” as used in this Section (d) of this Rule shall have the following meanings:

(A) “Compensation” shall mean cash compensation and non-cash compensation.

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(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

**(2) Restrictions on Non-Cash Compensation**

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors<sup>1</sup> and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by subparagraph (d)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the issuer or affiliate thereof, the office of the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

<sup>1</sup> The current annual amount fixed by the Board of Governors is \$100.

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(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target or any other non-cash compensation arrangement permitted by subparagraph (d)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in subparagraph (d)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by subparagraphs (d)(2)(C)-(E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with subparagraph (d)(2)(C)-(E).

(d) Renumbered as (e).

\* \* \* \* \*

#### **2810. Direct Participation Programs**

(a) No Change.

##### **(b) Requirements**

(1) through (3) No Change.

##### **(4) Organization and Offering Expenses**

(A) through (D) No Change.

(E) [No member or person associated with a member shall directly or indirectly accept any non-cash compensation or sales incentive item including, but not limited to, travel bonuses, prizes, and awards offered or provided to such member or its associated persons by any sponsor, affiliate of a sponsor or program. Notwithstanding the foregoing, a member may provide non-cash compensation or sales incentive items to its associated persons provided that no sponsor, affiliate of a sponsor or program, including specifically an affiliate

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of the member, directly or indirectly participates in or contributes to providing such non-cash compensation. Further, this subparagraph shall not prohibit a person associated with a member from accepting any non-cash sales incentive item offered directly to that person by a sponsor, affiliate of a sponsor or program where:

(i) the aggregate value of all such items paid by any sponsor or affiliate of a sponsor to each associated person during any year does not exceed \$100.00;

(ii) the value of all such items to be made available in connection with an offering is included as compensation to be received in connection with the offering for purposes of subparagraph (B); and

(iii) the proposed payment or transfer of all such items is disclosed in the prospectus or similar offering document,]

(F) Renumbered to (E).

(5) through (6) No Change.

**(c) Non-Cash Compensation**

**(1) Definitions**

The terms "compensation," "non-cash compensation" and "offeror" as used in this Section (c) of this Rule shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of direct participation securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, sponsor, an adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities.

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## (2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors<sup>1</sup> and are not conditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by subparagraph (c)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the offeror is not conditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by subparagraph (c)(2)(D).

<sup>1</sup> The current annual amount fixed by the Board of Governors is \$100.

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(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in subparagraph (c)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by subparagraphs (c)(2)(C)-(E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with subparagraph (c)(2)(C)-(E).

(c) Renumbered as (d).

\* \* \* \* \*



# Notice to Members

SEPTEMBER 2003

REQUEST FOR COMMENT      ACTION REQUESTED BY OCTOBER 17, 2003

## SUGGESTED ROUTING

Advertising/Investment Companies  
Executive Representatives  
Legal & Compliance  
Mutual Fund  
Registered Representatives  
Senior Management

## Compensation for the Sale of Investment Company Securities

NASD Requests Comment on Proposed Amendments to  
Rule 2830 (Investment Company Securities); **Comment  
Period Expires October 17, 2003**

## KEY TOPICS

NASD Rule 2830  
Revenue Sharing  
Investment Companies  
Advertising  
Variable Contracts

### Executive Summary

NASD proposes to amend Rule 2830 to require disclosure of revenue sharing and differential cash compensation arrangements relating to the sale of investment company securities. The proposal would require that a member disclose these compensation arrangements in writing when a customer first opens an account or purchases fund shares. The proposal also would require a member to update this information twice a year and make updates available to each customer.

NASD's proposal would:

- ◆ Broaden the definition of "cash compensation" in Rule 2830(b)(1)(C) to include cash payments received for inclusion of an investment company on a preferred sales list, in any other sales program (e.g., for shelf space) or as expense reimbursements;
- ◆ Add definitions of "differential cash compensation" and "gross dealer concessions" to Rule 2830(b); and
- ◆ Revise Rule 2830(l)(4) to ensure that members disclose revenue sharing arrangements and differential cash compensation arrangements to customers.

03-54

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## Questions/Further Information

Questions concerning this *Notice to Members* may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight, at (240) 386-4534; or Angela C. Goelzer, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight, at (202) 728-8120.

## Request for Comment

NASD requests comment on the proposed amendments to Rule 2830 described in this *Notice*. Members wishing to comment must make a submission that is received by **October 17, 2003**. Members and interested persons can submit their comments using the following methods:

- ◆ mailing in written comments
- ◆ e-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com)
- ◆ submitting comments online at the NASD Web Site ([www.nasd.com](http://www.nasd.com))

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
1735 K Street, NW  
Washington, DC 20006-1500

**Important Note:** The only comments that will be considered are those submitted in writing by mail or e-mail.

Before becoming effective, any rule change resulting from this proposal must be adopted by the NASD Regulation Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the Securities and Exchange Commission (SEC).

## Background

NASD members and their registered representatives are compensated for the sale of mutual fund shares in various ways, and the disclosure that investors receive depends upon the particular compensation arrangement. For example, member compensation that is deducted from a shareholder account or from fund assets, such as sales charges and Rule 12b-1 fees, is disclosed in the fee table that appears in the mutual fund prospectus. Other forms of member compensation, such as payments from a mutual fund adviser for "shelf space," have been the subject of less prominent disclosure.

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NASD reminds members that compensation arrangements may never undermine a member's obligation to properly supervise its registered representatives, or a registered representative's obligation to make only suitable recommendations to customers.<sup>1</sup> Members must adopt and implement procedures reasonably designed to ensure that all communications of their registered representatives concerning investment company products, whether written or oral, are accurate and complete.<sup>2</sup> In recommending an investment company, registered representatives must disclose all material information, including the fund's expenses and sales charges, investment objective and risks.

### **1. Rule 2830**

NASD rules regulate various compensation arrangements that present specific investor protection concerns. For example, NASD Conduct Rule 2830 effectively prohibits the payment of any form of compensation from third-party offerors to a member's associated persons. Rule 2830(l)(4) provides that a member may not accept cash compensation from an investment company offeror unless the compensation is described in the investment company's prospectus. The rule also prohibits a member from entering into "special cash compensation arrangements" with an investment company offeror unless the prospectus discloses the details of the arrangements. Earlier this year, NASD fined and censured two members for failing to disclose special cash compensation paid to dealer firms and to a group of registered representatives for the sale of mutual fund shares.<sup>3</sup>

Rule 2830(l)(5) prohibits the payment of most forms of non-cash compensation, such as lavish gifts and trips to resort locations, to registered representatives.<sup>4</sup> NASD has made clear to its members that this prohibition will be enforced in a manner that is appropriate in light of the purposes of the rule. Thus, for example, NASD has narrowly interpreted the "training and education exception" to the rule, forbidding reimbursement for tours, golf outings, and other forms of entertainment in connection with so-called "training and education meetings."<sup>5</sup>

### **2. Proposed Amendments**

NASD is now proposing a disclosure approach concerning two types of compensation arrangements that present investor protection concerns. These two types of compensation arrangements are:

- ◆ Revenue sharing arrangements, in which an investment adviser or other offeror agrees to pay an NASD member cash compensation not otherwise disclosed in the prospectus fee table (such as payments for "shelf space" to distribute the investment company's shares); and
- ◆ Differential cash compensation arrangements, typically occurring when a member provides higher payouts to its registered representatives for the sale of certain investment company products, such as investment companies that are proprietary funds of the member.

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Revenue sharing and differential cash compensation arrangements may create incentives to inappropriately favor some funds over others, or to favor funds over non-fund investments. These compensation arrangements can create conflicts of interest by encouraging members and their registered representatives to recommend certain funds to maximize their compensation, rather than to best meet their customers' needs. They may provide point-of-sale incentives that could compromise proper customer suitability considerations and may present a situation in which the salesperson's interests are not, in some circumstances, fully aligned with the interests of customers.

Disclosure of revenue sharing and differential cash compensation arrangements would enable investors to evaluate whether a registered representative's particular product recommendation was inappropriately influenced by these arrangements. Disclosure of these arrangements could be an important adjunct to existing suitability, sales practice, and disclosure requirements and may help ensure that there is an appropriate match between the needs of an investor and the most appropriate investment company.

Congress and the SEC also are considering the adequacy of disclosure regarding mutual fund fees and broker/dealer compensation for fund sales, and Congress may enact legislation or the SEC may issue separate proposals addressing these matters. In July, SEC Chairman Donaldson asked his staff "to move ahead with the prospectus disclosure recommendations of the Task Force on Breakpoints and to develop additional investor protection initiatives concerning the costs and conflicts of interest in mutual fund investments." Chairman Donaldson also anticipated that "the Commission will consider additional regulation in this critical area of our markets in the near future."<sup>6</sup> It is possible that Congressional or SEC action would require enhanced disclosure in the mutual fund prospectus, periodic reports, or confirmation statements. Such enhanced disclosure will be complementary to NASD's proposal. NASD will continue to work with Congress and the SEC on these investor protection initiatives.

## The Proposal

### 1. Required Disclosure

NASD proposes to amend Rule 2830 to better ensure that members disclose to their customers information about revenue sharing and differential cash compensation arrangements. The proposal recognizes that both revenue sharing and differential cash compensation arrangements may come in a variety of forms. For example, revenue sharing arrangements may include cash payments from a fund's investment adviser and expense reimbursements. A differential cash compensation arrangement may consist of a system under which a firm imposes ticket charges on their registered representatives for the sale of some, but not all, investment companies. Thus, a registered representative may not have to pay a ticket charge for the sale of a proprietary investment company, but may have to pay one for the sale of a nonproprietary investment company.

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Rule 2830(l)(4) would be revised to require that any member that within the previous twelve months has received from an investment company offeror cash compensation, or that uses differential cash compensation policies in compensating its associated persons, must disclose:

- ◆ That information about a fund's fees and expenses may be found in the fee table located in the fund's prospectus and that the fund's statement of additional information contains information about how the fund selects brokers.
- ◆ If applicable, that the member receives cash payments from fund offerors other than the sales charges (including Rule 12b-1 fees) and service fees disclosed in the prospectus fee table. The member also would have to list the offerors that made these payments to the member in descending order based upon the total amount of compensation received from each offeror. The member would not have to disclose the actual amounts of compensation received under these arrangements.<sup>7</sup>
- ◆ If applicable, that an associated person (including a registered representative or branch manager) receives different rates of compensation depending upon which investment company shares are purchased by a customer, the nature of these arrangements, and the names of the investment companies favored by these arrangements. This disclosure requirement would not apply to arrangements under which different associated persons receive different payout ratios, so long as an individual associated person receives the same payout ratio for all funds that he or she sells. This disclosure requirement also would not apply to differences in total compensation received by the associated person, such as for the sale of an investment company that provides a higher gross dealer concession to the member, provided that the payout ratios are the same for all funds that the associated person sells.
- ◆ A Web page or toll-free telephone number that a customer may use to obtain updated information about the member's revenue sharing and differential cash compensation arrangements. A member may choose not to maintain a Web page or toll-free number that provides updated information, but then must disclose that updated information will be sent to the customer on a semi-annual basis.

Rule 2830 also would be amended to provide that the required disclosures must be updated on a semi-annual basis and must be made in writing to the customer:

- ◆ At the time that the customer establishes an account with the member or the member's clearing broker;
- ◆ If no account is established, at the time that the customer first purchases shares of an investment company;

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- ◆ For accounts that are in existence at the time that the proposed revisions to Rule 2830 become effective, at the later of ninety days after the effective date or the time at which the customer first purchases fund shares following the effective date.

The proposal would retain, with modification, the current requirements in Rule 2830(l)(4) regarding prospectus disclosure of cash compensation arrangements.<sup>8</sup> The modifications are designed to clarify a member's obligation not to accept any sales charges or service fees that are not described in a current fund prospectus. If a special sales charge or service fee arrangement is made available to some, but not all, members who distribute a fund's securities, the arrangement must be described in the fund's prospectus. Thus, consistent with current policy, if an offeror pays a higher percentage of a mutual fund's sales charges to one member than it pays to other members, the details of this special cash compensation arrangement would have to be disclosed in the fund's prospectus. NASD has interpreted Rule 2830(l)(4) to allow this required disclosure to be presented in a fund's Statement of Additional Information (SAI).<sup>9</sup>

NASD seeks comment on whether SAI disclosure is an effective means to communicate with investors about special cash compensation arrangements. Should NASD require prospectus, rather than SAI, disclosure of these arrangements? Should the current requirements of Rule 2830(l)(4) be eliminated in light of the disclosure that would be required by the proposed amendments? If prospectus disclosure requirements are retained, should NASD provide additional guidance concerning the circumstances under which Rule 2830(l)(4) mandates disclosure and the level of detail that may be deemed appropriate?

## **2. Cash Compensation**

The definition of "cash compensation" set forth in Rule 2830(b)(1)(C) would be amended to include cash payments received as a condition for inclusion of the investment company on a preferred or select sales list, in any other sales program (e.g., for shelf space), or as expense reimbursement.<sup>10</sup> The definition also would be clarified to expressly include gross dealer concessions.

## **3. Differential Cash Compensation**

Rule 2830(b)(1) would be amended to add a definition of "differential cash compensation." The definition is designed to encompass any compensation arrangement under which a member pays an associated person different rates of compensation depending upon which investment company securities (or classes thereof) are sold. For example, a differential cash compensation arrangement would be deemed to exist whenever a member pays an associated person a higher percentage of the member's "gross dealer concessions" for the sale of one fund's securities than the percentage paid for sale of the same dollar amount of another fund's securities. A differential compensation arrangement also would be found when a member sponsors a cash sales contest with sales targets that favor certain funds, or when a member imposes or waives ticket charges for the sale of certain funds. The proposed definition

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would not be limited to differential cash compensation arrangements favoring proprietary funds. Also, the definition would encompass payments to any associated person, including a registered representative or branch manager.

NASD requests comment on whether money market funds should be excluded from the differential cash compensation provision. For example, a differential cash compensation arrangement could be deemed to exist whenever payout ratios are higher for the sale of one investment company than for another investment company that is not a money market fund. This provision would permit lower payouts for money market funds without mandating disclosure.

#### **4. Gross Dealer Concessions**

Integral to the proposed definition of “differential cash compensation” is NASD’s proposed definition of “gross dealer concessions.” Gross dealer concessions would be defined as the total amount of any compensation received by a member from an offeror for the sale of investment company securities, including all discounts, concessions, service fees, commissions, and asset-based sales charges.

#### **5. Alternative Approaches**

NASD seeks comments on alternatives to the proposed amendments. For example:

- ▶ As proposed, a member would provide the required disclosure when a customer first establishes an account with a member or the member’s clearing broker, or when the customer first purchases investment company shares. Are these the most appropriate times for a customer to receive the information? Would it be more appropriate for a customer to receive the information when he or she first receives a recommendation to purchase investment company shares, rather than at the opening of a brokerage account?
- ▶ Would investors be well served by disclosure that provides a general “warning label” urging them to seek information from the member or its associated person concerning revenue sharing and differential cash compensation arrangements, rather than receiving a list of relevant funds?
- ▶ In addition to the proposed disclosure, should NASD require disclosure of the actual dollar amounts paid under revenue sharing and differential cash compensation arrangements?
- ▶ What are the costs and benefits of the proposed amendments and the alternative approaches?
- ▶ Are there any other types of arrangements that should be covered by the rule due to the conflicts of interest that may be presented?

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With regard to disclosure of revenue sharing arrangements:

- ◆ NASD specifically seeks comment on whether it would be appropriate for Rule 2830 to establish a de minimis threshold below which disclosure of revenue sharing would not be required and, if so, the appropriate level of a threshold for disclosure.
- ◆ As proposed, a member that receives revenue sharing payments would be required to list the offerors that make the payments in descending order based upon the amount received by each. NASD requests comment on whether other listing requirements would be more appropriate. For example, offerors could be grouped according to the size of their revenue sharing payments (e.g., by highest to lowest quartile or quintile), without ranking the offerors in descending order within each group. Another alternative might be to list offerors according to revenue sharing payments per \$10,000 in fund sales, rather than based on total payments per fund.

NASD also seeks comment on whether the proposed definition of differential cash compensation should be broadened. As proposed, differential cash compensation would include arrangements in which a registered representative receives a higher percentage of the gross dealer concession for one fund than he or she would receive for the sale of another investment company. One alternative would be to expand this definition to include other circumstances in which the sale of the same dollar amount of different funds results in differing levels of compensation. For example, a registered representative may receive identical payout ratios for the sale of different funds, but the sale of one may result in higher compensation because the gross dealer concession is greater in absolute dollars.

More generally, NASD seeks comment on whether the proposal should be expanded to require disclosure of revenue sharing and differential compensation arrangements with respect to products other than investment companies, such as variable annuities. Would imposition of the proposed disclosure requirements solely on investment companies create incentives for registered representatives to favor other investment products?



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## Endnotes

- 1 NASD strictly monitors its members' sales practices in connection with the distribution of mutual funds and related investment products. For example, NASD's heightened scrutiny of sales practices in connection with the distribution of both mutual funds and variable annuities has resulted in over 75 disciplinary actions since the beginning of 2001.
- 2 See, e.g., *Notice to Members 98-107* (NASD Reminds Members Of Their Obligation To Disclose Mutual Fund Fees) and *Notice to Members 94-16* (NASD Reminds Members Of Mutual Fund Sales Practice Obligations).
- 3 See *NASD Regulatory and Compliance Alert* (Spring 2003). The respondents did not admit or deny the allegations but consented to the entry of findings.
- 4 See *Notice to Members 98-75* (amending Rules 2820 and 2830 to limit the extent to which members may pay or accept non-cash compensation).
- 5 See *NASD Regulatory and Compliance Alert* (Summer 2000).
- 6 SEC Press Release No. 2003-84 (July 22, 2003).
- 7 The proposal would not require a member to disclose receipt of non-cash compensation permitted by Rule 2830(l)(5), such as gifts under \$100, occasional meals, tickets to theater and sporting events, and reimbursement for associated persons' expenses in attending permissible training or education meetings.
- 8 Rule 2830(l)(4) provides in part that "[n]o member shall accept any cash compensation from an offeror unless such compensation is described in a current prospectus of the investment company. When special cash compensation arrangements are made available by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the investment company securities of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus."
- 9 See *Notice to Members 99-55* (Question #18).
- 10 Thus, the definition of "cash compensation" would include payments, made from an offeror other than an investment company, received by members for the sale of fund shares or payments based on the amount of fund assets held in accounts at the member. The definition would not include directed brokerage to a member. Of course, the prohibitions of Rule 2830(k) would still apply even after adoption of the proposed amendments. Rule 2830(k) generally prohibits a member from directly or indirectly seeking brokerage commissions as a condition to the sale or distribution of investment company securities.

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## ATTACHMENT A

### Text of Proposed Amendments

Rule 2830(b)(1)(C) is revised to read as follows:

(C) "Cash compensation" shall mean any cash payment received in connection with the sale or distribution of investment company securities, including but not limited to:

- (i) any discount, concession, gross dealer concession, fee, service fee, commission, asset-based sales charge, loan, override, cash employee benefit; or
- (ii) any cash payment received as a condition for inclusion of the investment company on a preferred or select sales list; in any other sales program; or as an expense reimbursement.

New Rules 2830(b)(1)(F) and (G) are inserted as follows:

(F) "Differential cash compensation" shall mean

- (i) the payment by a member to its associated persons of a higher percentage of the member's gross dealer concessions for the sale of a stated dollar amount of the securities of a particular investment company (or any class thereof) than the percentage of its gross dealer concessions that the member pays to its associated persons for the sale of the same dollar amount of securities of another investment company (or any class thereof); and
- (ii) other practices of a member that cause an associated person to earn different rates of compensation for investment company products (or classes thereof) depending on the product sold, including but not limited to a member's payment of additional cash compensation or the imposition or waiver of ticket charges for associated persons concerning the sale of particular investment company securities.

(G) "Gross dealer concessions" shall mean the total amount of any discounts, concessions, fees, service fees, commissions or asset-based sales charges provided by the offeror to the member in connection with the sale and distribution of investment company securities.

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Rule 2830(l)(4) is revised to read as follows:

(A) No member shall accept any sales charges or service fees from an offeror unless such compensation is described in a current prospectus of the investment company. When special sales charge or service fee arrangements are made available by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the investment company securities of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus.

(B) Any member that has within the previous 12 months received from an offeror any form of cash compensation, other than sales charges or service fees disclosed in the prospectus fee table, or that employs policies that involve differential cash compensation, must:

(i) disclose that information about an investment company's fees and expenses may be found in the fund's prospectus and that the company's policies regarding selection of brokers (including soft dollar practices) may be found in the fund's statement of additional information;

(ii) disclose, if applicable, that the member receives cash payments from an offeror, other than sales charges or service fees disclosed in the prospectus fee table, the nature of any such cash payments received in the past 12 months, and the name of each offeror that made such a cash payment, listed in descending order based upon the amount of compensation received from each offeror;

(iii) disclose, if applicable, that the associated person receives different rates of compensation for different investment company products that may provide an incentive to offer specific products to the customer, a description of the differential cash compensation policy, and the names of the investment company or companies whose sales the policy favors; and

(iv) provide a reference (or in the case of electronically delivered documents, a hyperlink) to the web page or toll-free telephone number described in paragraph (D). If the member elects not to maintain a web page or toll-free telephone number as described in paragraph (D), the member must disclose that updated information described in this paragraph (B) will be sent to the customer on a semi-annual basis.

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(C) The disclosure required by paragraph (B) must be updated on a semi-annual basis and must be made in written documentation:

(i) at the time that the customer establishes an account with the member or the member's clearing broker;

(ii) if no such account is established, by the time the customer first purchases shares of an investment company; or

(iii) with respect to accounts existing when paragraph (B) becomes effective, the later of (a) 90 days after the effective date, or (b) the time the customer first purchases shares of an investment company after the effective date (other than purchases through reinvestment of dividends or capital distributions or through automatic investment plans).

(D) Any member that receives cash payments from investment companies and their affiliates, other than sales charges or service fees disclosed in the prospectus fee table, or that employs policies that involve differential cash compensation, must either:

(i) maintain a web page or toll-free telephone number that is available to the public and that provides updated information described in paragraph (B); or

(ii) send updated information described in paragraph (B) in written form on a semi-annual basis to its customers who originally received this disclosure.

(E) Other than disclosures regarding differential cash compensation, the requirements of Rule 2830(l)(4)(B) shall not apply to cash compensation in the form of a sales charge or service fee disclosed in the prospectus fee table of the offeror's investment company.