



August 5, 2005

Barbara Z. Sweeney  
Senior Vice President and Corporate Secretary  
NASD  
1735 K Street, NW  
Washington DC 20006-1500

Re: NASD Notice to Members 05-40

Dear Ms. Sweeney:

The Self-Regulation and Supervisory Practices Committee (the “Committee”) of the Securities Industry Association (“SIA”)<sup>1</sup> appreciates the opportunity to comment on NASD Notice to Members 05-40, which requests comments on proposed rule changes that would (i) expand the prohibitions of non-cash compensation to the sale and distribution of any security or type of security, and (ii) prohibit all product specific sales contests (“Rule Proposal”).

The Committee generally supports NASD’s proposed modifications, which we believe already exist as good business practices within many member firms. We agree that potential conflicts of interest underlying existing prohibitions relating to the payment or receipt of non-cash compensation may exist with respect to all securities and that expansion of the current rules may be warranted. We also agree that compensation arrangements, including sales contests and non-cash compensation, should not improperly differentiate among different types of investment products.

The Committee believes, however, that some of the language of the Rule Proposal requires further clarification and modification in order to avoid inadvertent application to legitimate business conduct that may not present a risk of conflict or investor harm. In that regard, we believe that some aspects of the Rule Proposal go beyond the stated intention of eliminating programs that provide inappropriate incentives, and as such could cause unintended consequences to the detriment of investors and member firms. We offer our specific comments below.<sup>2</sup>

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<sup>1</sup> The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA’s primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated \$236.7 billion in domestic revenue and an estimated \$340 billion in global revenues. (More information about SIA is available at: [www.sia.com](http://www.sia.com).)

<sup>2</sup> In addition to the comments contained herein, the Committee also generally supports the comments contained in the letter submitted by the Financial Services Institute.

## **Extension of Non-Cash Compensation Prohibitions to All Securities**

The Rule Proposal would eliminate the current non-cash compensation provisions<sup>3</sup> and replace them with a new Rule 2311, which would extend the current restrictions governing the non-cash compensation and sales contest to the sale or distribution of any security or type of security. Rule 2311 would prohibit members and associated persons from providing or accepting payments of any non-cash compensation, subject to certain exceptions, such as certain gifts or entertainment that are not preconditioned on the achievement of a sales target.

### *Non-Cash Compensation to Employees Based on Non-Sales Related Criteria*

While we fully appreciate NASD's desire to prohibit inappropriate incentive-based practices within firms, we believe that a broad reading of Rule 2311, and in particular 2311(b), could place significant and unintended limitations on legitimate firm practices that provide employees benefits that are not sales-related or incentive-based. For example, many firms may offer their employees an opportunity to participate in traditional team building activities, such as trips, outings, or holiday gatherings. It is unclear, however, whether this type of activity would be permissible under the new rules. Since these types of activities present little risk of conflict or investor harm, we respectfully request that NASD clarify that firms could continue to engage in this type of practice, and more generally, that the restrictions on non-cash compensation would not impair a firm's ability to compensate employees for reasons or criteria that are not sales-related. Notably, existing rules in connection with the sale and distribution of investment company securities and variable annuities permit firms to compensate their employees as they see fit, provided the compensation does not create or encourage certain conflicts of interest, such as promoting one fund over another. Such an approach, we believe, is reasonable and should be clearly adopted here as well.

## **Limitations on Training and Education Events**

The Committee also believes that NASD should clarify that the restrictions contained in proposed Rule 2311(b) do not apply to non-incentive based employee training or education. Again, if the objective of the Rule Proposal is to prohibit inappropriate incentive based programs and avoid potential conflicts of interest, we believe that these types of events should be excluded from the Rule altogether.

In addition, we also seek modification of the provision limiting the location of training and education meetings to the United States, which we believe to be unwarranted. Given the increasing internationalization of securities markets, many member firms and offerors conduct business in foreign locations. Consequently, they will often have offices, and indeed may be headquartered, outside of the United States. In such cases, we perceive no rational basis for restricting training to domestic venues, particularly since such meetings by definition would be non-incentive based. We

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<sup>3</sup> See Rules 2710(i) (REITs and other publicly offered securities), 2810(c) (Direct Participation Programs), 2820(g)(4) (variable contracts), and 2830(l)(5) (investment companies).

recommend, therefore, that NASD eliminate the reference to domestic locations and instead merely require that the venue be “appropriate to the purpose of the meeting.”

The same rationale applies to NASD’s proposed limitations on regional meetings. Under the Rule Proposal, firms may reimburse employees for attending training and education events held at U.S. regional locations provided the employees “work within that region.” As before, we believe that overriding factor should be the substance of the meeting, not the venue. Thus, provided a firm can demonstrate a reasonable basis for employee participation in the meeting, we do not believe that additional restrictions on the location are necessary or workable. Indeed, because firms and regulators may define the term “region” differently, we believe that this provision could be problematic and the subject of second-guessing by examiners.

Finally, the Committee also believes that the definition of “preconditioned on the achievement of a sales target” in the context of “training and education” also requires modification. In that regard, we suggest that the second sentence of Section (a)(5) would be unnecessary if the NASD provided a definition of “training and education” that could be better adhered to and monitored. The lack of clarity in this provision is likely to impact the special product area, given that advanced product training is inexorably linked to good sales practices. For example, it is not uncommon for firms to determine eligibility for, and at times *require*, advanced training for specialized products based entirely on backward-looking assessments of product sales during specified periods. In such situations, where travel, lodging and meals are to be reimbursed, we believe there are additional and valuable interests served that may make it appropriate for a special product provider to set sales threshold to ensure that the training opportunity is targeted to individuals who will be able to make best use of the information. We therefore recommend that NASD clarify that such training events, especially those of a recurring nature, are not included in the definition of “pre-conditioned on the achievement of a sales target.”

## **Conclusion**

We appreciate the opportunity to provide comments in response to NASD Notice to Members 05-40 and welcome the opportunity to discuss the proposal further. If you have any questions or require further information, please call the undersigned or Amal Aly, Vice President and Associate General Counsel at (212) 618-0568.

Sincerely,

John Polanin Jr.  
Chairman  
SIA Self-Regulation and  
Supervisory Practices Committee