

August 4, 2005

Via E-mail Delivery

Ms. Barbara Sweeney  
National Association of Securities Dealers  
Office of the Corporate Secretary  
1735 K Street NW  
Washington, DC 20006-1500

Re: Comments on Proposed Creation of a new Rule 2311 – Notice to  
Members 05-40

Dear Ms. Sweeney:

Pacific Select Distributors, Inc. (“PSD”) is a broker-dealer member firm of the National Association of Securities Dealers, Inc (“NASD”) and is a subsidiary of Pacific Life Insurance Company. PSD has an affiliate relationship and directly or indirectly owns majority control of six retail NASD member firms.

As President of PSD, I appreciate the opportunity to respond to the NASD’s request for comments on the proposed new Rule 2311 outlined in Notice to Members 05-40. We understand that the objective in the creation of Rule 2311 would be to prohibit all product specific sales contests and to apply existing non-cash compensation rules to all securities. Further, the new Rule 2311 would replace existing Rules 2710(i), 2810(c), 2820(g)(4) and 2830(l)(5) (hereinafter referred to as “Old Rules”).

We are sympathetic with the concept of extending the non-cash compensation rules to other securities not currently covered under the Old Rules. This extension also creates the opportunity to simplify the rules by consolidating them under one new rule.

However, we have concerns about several other aspects of the proposed changes.

- 1) The Old Rules made clear that a member firm was not subject to the narrow restrictions governing “training or education meetings” with respect to its own programs offered to its associated persons as long as no unaffiliated member or non-member firm was involved in “organization” of such non-cash compensation activities. Further, the Old Rules specifically permitted contributions by nonmember companies or other members to such activities as long as they were not involved in “organization” of the activities. These provisions were specifically included in the old rules to accommodate the widespread practice of broker-dealers providing conferences and meetings and other non-cash benefits for their associated persons and of having product sponsors and other vendors financially

underwrite such activities. The new Rule language appears to eliminate such activities<sup>1</sup> or, at least, subject such activities to the narrow strictures described under proposed 2311(b)(3). This would be a huge change for the industry and would have the effect of significantly reducing education and training opportunities for associated persons. Further, such a change would go far beyond the stated objectives for the Rule 3211 as stated in Notice to Members 05-40. **The applicable exceptions included in the Old Rules permitting members to utilize non-cash compensation and other incentives with their associated persons should be added to proposed Rule 2311<sup>2</sup>.**

- 2) Section (b) (3) should be clarified as only applying to education programs offered by non-affiliated companies and members. There is no reason to apply the restrictions on location, entertainment, covering guest costs, etc. for internal broker-dealer meetings, whether incentive based or not. The purpose of Rule 2311 is to reduce the impact of incentives on the associated person's choice of products (or – if implemented as proposed – on the associated person's choice of product lines) and not to place further limitations on the forms of compensation that member firms can utilize to compensate associated persons. Further the record keeping requirements should not be applied to internal broker-dealer meetings.
- 3) Section (b) (3) (C) should be modified by including economics as a reasonable basis for selecting a location for a meeting. For example if a particular site is less expensive than other alternatives, that alone should be adequate to justify selection of that location.
- 4) The Old Rules required that any non-cash compensation program that was limited to a single line of products could not favor a single product over other products in the same product line. All products within a particular product line were to be treated equally. The proposed Rule 2311 takes a big additional step by that all products in all product lines be treated equally. This would eliminate any incentive programs based on a specific product line. This is a major change that may have a negative impact on the marketing and education programs of members. **We believe that careful consideration should be given to both positive and negative impacts of this proposed change:**
  - Education and training programs focused on one product line are often beneficial and are often funded by sponsors specializing in that product line. Such programs also make a lot more sense if participation is based on associated persons whose production levels are higher in that same

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<sup>1</sup> Proposed Rule 2311 (b) "... 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..."

<sup>2</sup> Suggest amending proposed Rule 2311 by adding two additional exceptions (3) and (4) under 2311 (b) as follows: (3) Non-cash compensation arrangements between a member and its associated persons provided that no unaffiliated member or non-member company participates in the organization of the permissible non-cash arrangement. (4) Contributions by a member or non-member to a non-cash compensation arrangement between a member and its associated persons provided that the arrangement meets the criteria in subparagraph (b)(3).

product line. For example, the proposed amendments to variable annuity sales practices and supervisor standards (NASD Rule 2821 recently published for comment by the SEC) include a requirement for special education programs related to annuities. This type of training may be more difficult to implement and finance if Rule 3211 is adopted in its current form.

- The ability of a member to motivate its associated persons to focus more on a particular product line might be a very positive thing. For example, an incentive program to move from non-managed to managed investments, from non-diversified to diversified portfolios, etc. may be a good thing. Such opportunities would apparently be eliminated under the proposed Rule 2311.
- Since it is somewhat tied to product lines, consideration needs to be given to the impact that licensing has on the proposed Rule 2311. For example, a Series 6 license limits product lines that an associated person can utilize. Would this limit the effected associate from participating in non-cash compensation activities?
- Certain member firms and their associated persons still specialize in a single product line or a narrow number of product lines. It would seem awkward to require that such firms include all product lines in any incentive program. Further, to the extent that such firms are able to create incentive programs based on a single product line. That may give them a competitive advantage over other more diversified firms that are not able to compete by offering similar incentive programs.

We appreciate the opportunity to comment on Proposed Rule 2311. Please feel free to contact the undersigned if you have any questions or wish further clarification of our comments.

Respectfully submitted,

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