Notice to Members

JULY 2004

SUGGESTED ROUTING

Legal & Compliance

Senior Management

KEY TOPICS

Commodity Pools

Direct Participation Programs

Trail Commissions

Rule 2810

GUIDANCE

Commodity Pools

Treatment of Commodity Pool Trail Commissions under Rule 2810 (Direct Participation Programs Rule); **Effective Date: July 13, 2004**

Executive Summary

NASD Rule 2810 (Direct Participation Programs Rule or DPP Rule) governs public offerings of direct participation programs (DPPs), including establishing limits on the level of underwriting compensation. Historically, in reviewing the level of underwriting compensation in commodity pool DPPs, NASD staff has excluded certain trail commissions. This *Notice* serves to advise members that effective immediately, NASD staff will consider all trail commissions paid in connection with commodity pool DPPs in calculating whether the level of underwriting compensation meets the requirements of Rule 2810.

Questions/Further Information

Questions concerning this *Notice* may be directed to Joseph E. Price, Vice President and Director, Corporate Financing Department, at (240) 386-4642; or Gary L. Goldsholle, Associate Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8104.

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Discussion

The DPP Rule requires that, prior to participating in a public offering of securities, a member (or another member on its behalf) must file information regarding the DPP offering with NASD's Corporate Financing Department (Department) and receive a "no objections" opinion. The "no objections" opinion takes into account the proposed terms and arrangements of the DPP offering, including the level of underwriting compensation, which may not exceed 10 percent of the gross proceeds of the offering.

Historically, in calculating the level of underwriting compensation for commodity pool DPPs, NASD staff has excluded certain trail commissions. In particular, NASD staff excluded trail commissions paid to an associated person of a member if:

(1) the member was registered with the Commodity Futures Trading Commission as a Futures Commission Merchant;

(2) the associated person receiving the trail commissions had passed the National Commodity Futures Examination (Series 3) or the Futures Managed Funds Examination (Series 31); and

(3) the associated person receiving the trail commissions provided ongoing investor relations services to the investors.

The staff's position was predicated on the provision of a higher level of services by persons selling commodity pool DPPs and a certain level of proficiency as demonstrated by passing either the Series 3 or Series 31. In reconsidering this position, NASD sought comment from members and other interested parties in *Notice to Members 04-07* (Regulation of Compensation, Fees, and Expenses in Public Offerings of Real Estate Investment Trusts; Direct Participation Programs, Including Commodity Pools; and Closed-End Funds).

Most commenters opposed changing this position, noting differences between commodity pools and other DPPs, and the services generally provided to persons investing in commodity pool DPPs. Many commenters cited the benefits to investors of diversification by investing in commodities in general and in commodity pool DPPs in particular, but also warned that if the level of underwriting compensation was capped, then they may no longer be in a position to recommend commodity pool DPPs to investors. Several commenters believed that establishing compensation limits for selling commodity pool DPPs was appropriate, but urged limits higher than those currently in place for other DPPs.

Based upon NASD staff's review and analysis, including the comments received, NASD staff continues to believe the reasons underlying the exclusion of certain trail commissions of commodity pool DPPs no longer apply today. NASD staff has seen no evidence that, presently, commodity pool DPP investors receive a significantly higher level of service than investors in other DPPs, including real estate, oil and gas, and equipment leasing partnerships. Moreover, commenters failed to adequately explain the differences in service provided by persons who have passed the Series 3 or Series 31 (and thus met the exclusion) and those who have not (and thus remained subject to the compensation limits of the DPP Rule). Finally, NASD staff believes that notwithstanding a limit on the level of underwriting compensation, firms and registered representatives will continue to offer and recommend commodity pool DPPs where there are benefits to investors in terms of diversification and where such products meet investors' financial status and investment objectives. Accordingly, NASD staff will no longer exclude the payment of any trail commissions for commodity pool DPPs from the underwriting compensation limits in the DPP Rule, regardless of whether such payments meet the three conditions discussed above. Effective immediately, in determining whether to issue a "no objections" opinion in connection with a commodity pool DPP filed with the Department under Rule 2810, NASD staff will consider, among other things, whether the level of underwriting compensation, including the types of trail commissions previously excluded, exceeds the 10 percent limitation in the DPP Rule.[1]

Endnote

1 This interpretation does not alter the compensation that may be paid in offerings of commodity pool DPPs that have already been approved by the Department. However, future offerings of commodity pool DPPs, even additional offerings of securities by commodity pool DPPs previously approved by the Department, must adhere to the compensation limits of the DPP Rule.