

Investment Company Securities

FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Investment Company Securities

Comment Period Expires: August 3, 2009

Executive Summary

As part of the process to develop a new consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on a proposed FINRA rule regarding the distribution and sale of investment company securities. The proposal is based on NASD Rule 2830, subject to certain changes, including proposed new requirements regarding disclosure of cash compensation.

The text of the proposed rule is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Joe Savage, Vice President and Counsel, Investment Companies Regulation, at (240) 386-4534; or
- ▶ Stan Macel, Assistant General Counsel, Office of General Counsel, at (202) 728-8056.

June 2009

Notice Type

- ▶ Request for Comment
- ▶ Consolidated FINRA Rulebook

Suggested Routing

- ▶ Compliance
- ▶ Executive Representatives
- ▶ Investment Companies
- ▶ Legal
- ▶ Mutual Fund
- ▶ Registered Representative
- ▶ Senior Management

Key Topics

- ▶ Cash Compensation
- ▶ Exchange-Traded Funds
- ▶ Investment Companies
- ▶ Non-Cash Compensation
- ▶ Revenue Sharing

Referenced Rules & Notices

- ▶ FINRA Rule 5110
- ▶ NASD Rule 2830
- ▶ NASD Rule 2810
- ▶ NTM 03-54
- ▶ NTM 99-55

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by August 3, 2009.

Member firms and other interested parties can submit their comments using the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes

The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.²

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.³

Discussion

FINRA is proposing to adopt FINRA Rule 2341 regarding the regulation of members' activities in connection with the sale and distribution of registered investment company securities. Proposed FINRA Rule 2341 is based largely on NASD Rule 2830, with some significant changes, discussed below.⁴

NASD Rule 2830

NASD Rule 2830 regulates member firms' activities in connection with the distribution and sale of investment company securities. Proposed FINRA Rule 2341 revises the provisions of NASD Rule 2830 in four areas. It:

- ▶ requires firms to make new disclosures to investors regarding the receipt of cash compensation;
- ▶ makes a minor change to the recordkeeping requirements for non-cash compensation;
- ▶ eliminates a condition regarding discounted sales of investment company securities to dealers; and
- ▶ codifies past FINRA staff interpretations regarding the purchases and sales of exchange-traded funds (ETFs).

These proposed changes are discussed in more detail below.

Proposed Changes to the Cash Compensation Provisions

NASD Rule 2830(l) governs the payment and acceptance of cash and non-cash compensation in connection with the sale of investment company securities. Among other things, NASD Rule 2830(l)(4) prohibits member firms from accepting cash compensation from an "offeror" (generally an investment company and its affiliates), unless the compensation is described in the fund's current prospectus. If a member firm enters into a "special cash compensation" arrangement with an offeror, and the offeror does not make the arrangement available on the same terms to all member firms that sell the fund's shares, the member firm's name and the details of the arrangement must be disclosed in the prospectus.⁵

FINRA proposes to modify the disclosure requirements for cash compensation arrangements in several respects.⁶ First, the proposal requires that standard "sales charges and service fees" (rather than all cash compensation) be described in the prospectus.⁷ Second, the proposal eliminates the term "special cash compensation" and instead requires prospectus disclosure where a member firm received greater (or special) sales charges or service fees than are ordinarily paid in connection with sales of fund shares. Other types of cash compensation, such as revenue-sharing payments,⁸ would not require prospectus disclosure. Like the current rule, the proposal requires the names of the firms that have entered into arrangements to receive special sales charges or service fees and the details of these arrangements to be disclosed in the prospectus or SAI.

Third, the proposal requires a member firm that receives cash payments in addition to the standard sales charges and service fees paid in connection with the sale of fund shares to make certain disclosures to its customers at the time the account is opened.⁹ These additional cash payments could take the form of higher sales commissions or service fees, or revenue sharing payments made by offerors to firms. If a member firm receives additional cash compensation from an offeror, it would have to:

- (1) disclose that information about a fund's fees and expenses may be found in the fund's prospectus;
- (2) if applicable, disclose the following:
 - that the firm receives cash payments from offerors in addition to the standard sales charges and service fees disclosed in the prospectus;
 - the nature of such payments received in the last 12 months; and
 - a list of offerors making such payments listed in descending order of payments received; and
- (3) provide a reference to a Web page or toll-free number containing updated information, which must be updated at least every six months. Alternatively, if the firm elects not to maintain a Web page or toll-free number, it must disclose updated information to customers every six months.

FINRA seeks comment on how this information should be disclosed to investors, particularly given the availability of the Internet. Should firms be permitted to deliver initial disclosure information (*i.e.*, information described in items 1 and 2 above) to customers electronically, unless a customer specifically requests paper-based disclosure? Alternatively, should the rule allow firms to provide generalized disclosure (in either paper or electronic format) to an investor when an account is opened regarding the receipt of cash compensation that refers the investor to a Web site address or toll-free number that provides the information described in items 1 and 2 above?

Fourth, the staff proposes to add supplementary material that clarifies provisions regarding the disclosure of cash compensation and that would supersede all prior guidance with respect to these provisions. Among other things, the supplementary material provides that:

- (1) cash compensation includes revenue sharing paid in connection with the sale and distribution of investment company securities (and therefore member firms would be required to disclose revenue sharing arrangements pursuant to the rule); and
- (2) a special sales charge or service fee arrangement includes any arrangement under which a member firm receives greater sales charges or service fees than other member firms selling the same investment company securities, even if an offeror would have made the same arrangement available to other member firms had they requested it.

Proposed Changes to the Non-Cash Compensation Provisions

NASD Rule 2830(l)(5) generally prohibits member firms and their associated persons from accepting or making payments of non-cash compensation in connection with the sale of investment company securities, subject to certain exceptions. These exceptions allow gifts of under \$100, entertainment that does not raise questions of propriety, certain training or education meetings, and sales contests that do not favor particular products.

NASD Rule 2830(l)(3) requires member firms to keep records of all compensation received by the member firm or its associated persons from offerors, other than small gifts and entertainment permitted by the rule. Currently, this provision requires the records to include the nature of and, "if known," the value of any non-cash compensation received. FINRA proposes to modify this requirement by deleting the phrase "if known" regarding the value of non-cash compensation. This change would make the provision more consistent with the non-cash compensation recordkeeping requirements in other FINRA rules.¹⁰ Firms would be permitted to estimate in good faith the actual value of non-cash compensation received for which a receipt (or similar documentation) assigning a value is not available.¹¹

Proposed Changes Regarding Conditions for Discounts to Dealers

NASD Rule 2830(c) currently prohibits investment company underwriters from selling the fund's securities to a retail broker-dealer at a price other than the public offering price unless they meet two requirements:

- ▶ the sale must be in conformance with NASD Rule 2420 (Dealing with Non-Members); and
- ▶ for certain investment company securities, a sales agreement must be in place that sets forth the concessions paid to the retail firm.

The requirement that the sale be in conformance with NASD Rule 2420 is based on historical concerns that both underwriters and dealers of investment company securities be members. Since the time this provision was adopted, the laws governing broker-dealers have changed, and today virtually all broker-dealers doing business with the public are FINRA members. As a result of this change, FINRA proposes eliminating the requirement that the sale be in conformance with Rule 2420.

Proposed Changes Regarding Sales of ETFs

In recent years, member firms have bought and sold shares of ETFs, which are open-end investment companies or unit investment trusts (UITs) that differ from traditional mutual funds and UITs, since their shares typically are traded on securities exchanges. Because ETF shares are sometimes traded at prices that differ from the fund's current net asset value, ETFs can raise issues both under the Investment Company Act and NASD Rule 2830. For example, Section 22(d) of the Investment Company Act requires dealers to sell shares of an open-end investment company at the current public offering price described in its prospectus (*i.e.*, the fund's net asset value plus any applicable sales load). Similarly, NASD Rule 2830(i) generally prohibits member firms from purchasing fund shares at a price lower than the bid price next quoted by or for the issuer (for traditional mutual funds, this price is the fund's current net asset value).

To address these issues, the SEC has issued a series of exemptive orders that allow ETFs to trade on exchanges at prices that differ from the fund's public offering price. The SEC also has proposed a rule that would codify the exemptive relief provided by its orders.¹² Similarly, FINRA staff has issued letters interpreting NASD Rule 2830 that allow member firms to purchase and sell shares of ETFs at prices other than the current net asset value consistent with SEC exemptive orders.¹³ As proposed, the new FINRA rule would add a provision, FINRA Rule 2341(o), to codify earlier FINRA staff interpretive letters that permit the trading of ETF shares at prices other than the current net asset value consistent with applicable SEC rules or exemptive orders.

Endnotes

- 1 The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *Information Notice 03/12/08* (Rulebook Consolidation Process).
- 2 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (Nov. 2003) (NASD Announces Online Availability of Comments) for more information.
- 3 Section 19 of the Securities Exchange Act of 1934 (SEA) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See SEA Section 19 and rules thereunder.
- 4 As with NASD Rule 2830, FINRA Rule 2341 would not regulate member firms' activities in connection with variable insurance contracts, which are regulated by NASD Rule 2820. The SEC recently approved FINRA's proposal to adopt NASD Rule 2820 with minor changes as FINRA Rule 2320 in the Consolidated FINRA Rulebook. See Exchange Act Release No. 60086 (June 10, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-023).
- 5 FINRA staff has interpreted this provision as permitting disclosure in a fund's statement of additional information (SAI) rather than in its statutory (printed) prospectus. See *Notice to Members 99-55* (July 1999), Question #18.
- 6 FINRA previously proposed similar changes to the cash compensation provisions of Rule 2830 in 2003. See *Notice to Members 03-54* (Sept. 2003).
- 7 The terms "sales charge" and "service fees" are defined in NASD Rule 2830 and would retain the same definitions in FINRA Rule 2341. "Sales charge" means "all charges or fees that are paid to finance sales or sales promotion expenses, including front-end, deferred and asset-based sales charges, excluding charges and fees for ministerial, recordkeeping or administrative activities and investment management fees." NASD Rule 2830(b)(8). "Service fees" include "payments by an investment company for personal service and/or the maintenance of shareholder accounts." NASD Rule 2830(b)(9).
- 8 Revenue-sharing payments can take many different forms. For example, a fund company may pay a firm additional amounts at year-end based on the amount a firm's customers currently hold in the offeror's funds, or based on the firm's total sales of the offeror's funds in the previous year. They can also take the form of other cash payments, such as an offeror helping to pay the costs of a firm's annual sales meeting. See, e.g., Securities Act Release No. 8358 (Jan. 24, 2004), 69 FR 6438 (Feb. 10, 2004), at 6441 n.17.
- 9 If the customer does not open an account with the broker-dealer or its clearing firm, such as when the customer has an account with a mutual fund transfer agent, this disclosure would have to be made before the initial shares are purchased.

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Endnotes (continued)

- 10 *See, e.g.*, recordkeeping requirements for non-cash compensation regarding public offerings of securities in FINRA Rule 5110(i)(2) and direct participation programs in NASD Rule 2810(c)(2). The SEC recently approved FINRA's proposal to adopt NASD Rule 2810 without material change as FINRA Rule 2310 in the Consolidated FINRA Rulebook. *See* Exchange Act Release No. 59987 (May 27, 2009), 74 FR 26909 (June 4, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-016).
- 11 The SEC recently approved FINRA's proposal to make a similar change to the recordkeeping requirements for non-cash compensation received in connection with the offer or sale of variable insurance products pursuant to current NASD Rule 2820 (which will become FINRA Rule 2320). *See supra* note 4.
- 12 Securities Act Release No. 8901 (Mar. 11, 2008), 73 FR 14618 (Mar. 18, 2008).
- 13 *See, e.g.*, Letter from Joseph P. Savage, Counsel, Investment Companies Regulation, NASD, to Kathleen H. Moriarty, Carter, Ledyard & Milburn (Oct. 30, 2002).

Attachment A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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Text of Proposed New FINRA Rule (Marked to Show Changes from NASD Rule 2830; NASD Rule 2830 to be Deleted in its Entirety from the Transitional Rulebook)

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2000. DUTIES AND CONFLICTS

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2300. SPECIAL PRODUCTS

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2340. Investment Companies

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[2830]2341. Investment Company Securities

(a) Application

This Rule shall apply exclusively to the activities of members in connection with the securities of companies registered under the Investment Company Act[of 1940 (“the 1940 Act”)]; provided, however, that Rule 2320[2820]1 shall apply, in lieu of this Rule, to members’ activities in connection with “variable contracts” as defined therein.

(b) Definitions

(1) The terms “affiliated member,” “compensation,” “cash compensation,” “non-cash compensation” and “offeror” as used in paragraph (l) of this Rule shall have the following meanings:

(A) “Affiliated Member” shall mean a member which, directly or indirectly, controls, is controlled by, or is under common control with a non-member company.

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

(C) “Cash compensation” shall mean any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override or cash employee benefit received in connection with the sale and distribution of investment company securities.

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

(E) “Offeror” shall mean an investment company, an adviser to an investment company, a fund administrator, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company [1940] Act) of such entities.

(2) “Brokerage commissions,” as used in paragraph (k), shall not be limited to commissions on agency transactions but shall include underwriting discounts or concessions and fees paid to members in connection with tender offers.

(3) “Covered account,” as used in paragraph (k), shall mean (A) any other investment company or other account managed by the investment adviser of such investment company, or (B) any other account from which brokerage commissions are received or expected as a result of the request or direction of any principal underwriter of such investment company or of any affiliated person (as defined in the Investment Company [1940] Act) of such investment company or of such underwriter, or of any affiliated person of an affiliated person of such investment company.

(4) “Person” shall mean “person” as defined in the Investment Company [1940] Act.

(5) “Prime rate,” as used in paragraph (d), shall mean the most preferential interest rate on corporate loans at large U.S. money center commercial banks.

(6) “Public offering price” shall mean a public offering price as set forth in the prospectus of the issuing company.

(7) “Rights of accumulation” as used in paragraph (d), shall mean a scale of reducing sales charges in which the sales charge applicable to the securities being purchased is based upon the aggregate quantity of securities previously purchased or acquired and then owned plus the securities being purchased. The quantity of securities owned shall be based upon:

- (A) The current value of such securities (measured by either net asset value or maximum offering price); or
- (B) Total purchases of such securities at actual offering prices; or
- (C) The higher of the current value or the total purchases of such securities.

The quantity of securities owned may also include redeemable securities of other registered investment companies having the same principal underwriter.

(8) “Sales charge” and “sales charges,” as used in paragraph (d) and paragraph (l)(4), shall mean all charges or fees that are paid to finance sales or sales promotion expenses, including front-end, deferred and asset-based sales charges, excluding charges and fees for ministerial, recordkeeping or administrative activities and investment management fees. For purposes of this Rule, members may rely on the sales-related fees and charges disclosed in the prospectus of an investment company.

(A) An “asset-based sales charge” is a sales charge that is deducted from the net assets of an investment company and does not include a service fee.

(B) A “deferred sales charge” is any amount properly chargeable to sales or promotional expenses that is paid by a shareholder after purchase but before or upon redemption.

(C) A “front-end sales charge” is a sales charge that is included in the public offering price of the shares of an investment company.

(9) “Service fees,” as used in paragraph (d) and paragraph (l)(4), shall mean payments by an investment company for personal service and/or the maintenance of shareholder accounts.

(10) The terms “underwriter,” “principal underwriter,” “redeemable security,” “periodic payment plan,” “open-end management investment company,” and unit investment trust,” shall have the same definitions used in the Investment Company [1940] Act.

(11) A “fund of funds” is an investment company that acquires securities issued by any other investment company registered under the Investment Company [1940] Act in excess of the amounts permitted under paragraph (A) of Section 12(d)(1) of the Investment Company [1940] Act. An “acquiring company” in a fund of funds is the investment company that purchases or otherwise acquires the securities of another investment company, and an “acquired company” is the investment company whose securities are acquired.

(12) “Investment companies in a single complex” are any two or more companies that hold themselves out to investors as related companies for purposes of investment and investor services.

(c) Conditions for Discounts to Dealers

No member who is an underwriter of the securities of an investment company shall sell any [such security to any dealer or broker at any price other than a public offering price unless such sale is in conformance with Rule 2420 and, if the] security that is issued by an open-end management company or by a unit investment trust which invests primarily in securities issued by other investment companies[,] to any dealer or broker at any price other than a public offering price unless a sales agreement is in effect between the parties as of the date of the transaction, which agreement shall set forth the concessions to be received by the dealer or broker.

(d) Sales Charge

No member shall offer or sell the shares of any open-end investment company, any closed-end investment company that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company [1940] Act and offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) under the Securities Act[of 1933], or any “single payment” investment plan issued by a unit investment trust (collectively “investment companies”) registered under the Investment Company [1940] Act if the sales charges described in the prospectus are excessive. Aggregate sales charges shall be deemed excessive if they do not conform to the following provisions:

(1) Investment Companies Without an Asset-Based Sales Charge

(A) Aggregate front-end and deferred sales charges described in the prospectus which may be imposed by an investment company without an asset-based sales charge shall not exceed 8.5% of the offering price.

(B) (i) Rights of accumulation (cumulative quantity discounts) may be made available to any person in accordance with one of the alternative quantity discount schedules provided in subparagraph (C)(i) below, as in effect on the date the right is exercised.

(ii) If rights of accumulation are not made available on terms at least as favorable as those specified in subparagraph (C)(i) the maximum aggregate sales charge shall not exceed 8.0% of the offering price.

(C) (i) Quantity discounts, if offered, shall be made available on single purchases by any person in accordance with one of the following two alternatives:

a. A maximum aggregate sales charge of 7.75% on purchases of \$10,000 or more and a maximum aggregate sales charge of 6.25% on purchases of \$25,000 or more; or

b. A maximum aggregate sales charge of 7.50% on purchases of \$15,000 or more and a maximum aggregate sales charge of 6.25% on purchases of \$25,000 or more.

(ii) If quantity discounts are not made available on terms at least as favorable as those specified in subparagraph (C)(i) the maximum aggregate sales charge shall not exceed:

a. 7.75% of offering price if the provisions of subparagraphs (B) are met.

b. 7.25% of offering price if the provisions of subparagraph (B) are not met.

(D) If an investment company without an asset-based sales charge pays a service fee, the maximum aggregate sales charge shall not exceed 7.25% of the offering price.

(2) Investment Companies with an Asset-Based Sales Charge

(A) Except as provided in subparagraphs (C) and (D), the aggregate asset-based, front-end and deferred sales charges described in the prospectus which may be imposed by an investment company with an asset-based sales charge, if the investment company has adopted a plan under which service fees are paid, shall not exceed 6.25% of total new gross sales (excluding sales from the reinvestment of distributions and exchanges of shares between investment companies in a single complex, between classes of an investment company with multiple classes of shares or between series of a series investment company) plus interest charges on such amount equal to the prime rate plus one percent per annum. The maximum front-end or deferred sales charge resulting from any transaction shall be 6.25% of the amount invested.

(B) Except as provided in subparagraphs (C) and (D), if an investment company with an asset-based sales charge does not pay a service fee, the aggregate asset-based, front-end and deferred sales charges described in the prospectus shall not exceed 7.25% of total new gross sales (excluding sales from the reinvestment of distributions and exchanges of shares between investment companies in a single complex, between classes of an investment company with multiple classes of shares or between series of a series investment company) plus interest charges on such amount equal to the prime rate plus one percent per annum. The maximum front-end or deferred sales charge resulting from any transaction shall be 7.25% of the amount invested.

(C) The maximum aggregate sales charge on total new gross sales set forth in subparagraphs (A) and (B) may be increased by an amount calculated by applying the appropriate percentages of 6.25% or 7.25% to total new gross sales which occurred after an investment company first adopted an asset-based sales charge until July 7, 1993 plus interest charges on such amount equal to the prime rate plus one percent per annum less any front-end, asset-based or deferred sales charges on such sales or net assets resulting from such sales.

(D) The maximum aggregate sales charges of an investment company in a single complex, a class of shares issued by an investment company with multiple classes of shares or a separate series of a series investment company, may be increased to include sales of exchanged shares provided that such increase is deducted from the maximum aggregate sales charges of the investment company, class or series which redeemed the shares for the purpose of such exchanges.

(E) No member shall offer or sell the shares of an investment company with an asset-based sales charge if:

(i) The amount of the asset-based sales charge exceeds .75 of 1% per annum of the average annual net assets of the investment company; or

(ii) Any deferred sales charges deducted from the proceeds of a redemption after the maximum cap described in subparagraphs (A), (B), (C) and (D) hereof, has been attained are not credited to the investment company.

(3) Fund of Funds

(A) If neither an acquiring company nor an acquired company in a fund of funds structure has an asset-based sales charge, the maximum aggregate front-end and deferred sales charges that may be imposed by the acquiring company, the acquired company and those companies in combination, shall not exceed the rates provided in paragraph (d)(1).

(B) Any acquiring company or acquired company in a fund of funds structure that has an asset-based sales charge shall individually comply with the requirements of paragraph (d)(2), provided:

(i) If the acquiring and acquired companies are in a single complex and the acquired fund has an asset-based sales charge, sales made to the acquiring fund shall be excluded from total gross new sales for purposes of acquired fund's calculations under [sub]paragraphs (d)(2)(A) through (d)(2)(D); and

(ii) If both the acquiring and acquired companies have an asset-based sales charge:

a. the maximum aggregate asset-based sales charge imposed by the acquiring company, the acquired company and those companies in combination, shall not exceed the rate provided in [sub]paragraph (d)(2)(E)(i); and

b. the maximum aggregate front-end or deferred sales charges shall not exceed 7.25% of the amount invested, or 6.25% if either company pays a service fee.

(C) The rates described in [sub]paragraphs (d)(4) and (d)(5) shall apply to the acquiring company, the acquired company and those companies in combination. The limitations of [sub]paragraph (d)(6) shall apply to the acquiring company and the acquired company individually.

(4) No member or person associated with a member shall, either orally or in writing, describe an investment company as being "no load" or as having "no sales charge" if the investment company has a front-end or deferred sales charge or whose total charges against net assets to provide for sales related expenses and/or service fees exceed .25 of 1% of average net assets per annum.

(5) No member or person associated with a member shall offer or sell the securities of an investment company if the service fees paid by the investment company, as disclosed in the prospectus, exceed .25 of 1% of its average annual net assets or if a service fee paid by the investment company, as disclosed in the prospectus, to any person who sells its shares exceeds .25 of 1% of the average annual net asset value of such shares.

(6) No member or person associated with a member shall offer or sell the securities of an investment company if:

(A) The investment company has a deferred sales charge paid upon redemption that declines over the period of a shareholder's investment ("contingent deferred sales load"), unless the contingent deferred sales load is calculated as if the shares or amounts representing shares not subject to the load are redeemed first, and other shares or amounts representing shares are then redeemed in the order purchased, provided that another order of redemption may be used if such order would result in the redeeming shareholder paying a lower contingent deferred sales load; or

(B) The investment company has a front-end or deferred sales charge imposed on shares, or amounts representing shares, that are purchased through the reinvestment of dividends, unless the registration statement registering the investment company's securities under the Securities Act [of 1933] became effective prior to April 1, 2000.

(e) Selling Dividends

No member shall, in recommending the purchase of investment company securities, state or imply that the purchase of such securities shortly before an ex-dividend date is advantageous to the purchaser, unless there are specific, clearly described tax or other advantages to the purchaser, and no member shall represent that distributions of long-term capital gains by an investment company are or should be viewed as part of the income yield from an investment in such company's securities.

(f) Withhold Orders

No member shall withhold placing customers' orders for any investment company security so as to profit [himself]itself as a result of such withholding.

(g) Purchase for Existing Orders

No member shall purchase from an underwriter the securities of any open-end investment company and no member who is an underwriter of such securities shall purchase such securities from the issuer, except (1) for the purpose of covering purchase orders previously received or (2) for its own investment. Nothing herein shall be deemed to prohibit any member from purchasing securities of any investment company specifically designed for short-term investment (e.g., money market fund).

(h) Refund of Sales Charge

If any security issued by an open-end management investment company is repurchased by the issuer, or by the underwriter for the account of the issuer, or is tendered for redemption within seven business days after the date of the transaction, (1) the dealer or broker shall forthwith refund to the underwriter the full concession allowed to the dealer or broker on the original sale and (2) the underwriter shall forthwith pay to the issuer the underwriter's share of the sales charge on the original sale by the underwriter and shall also pay to the issuer the refund which [he]it received under subparagraph (1) when [he]it receives it. The dealer or broker shall be notified by the underwriter of such repurchase or redemption within ten days of the date on which the certificate or written request for redemption is delivered to the underwriter or issuer. If the original sale was made directly to the investor by the principal underwriter, the entire sales charge shall be paid to the issuer by the principal underwriter.

(i) Purchases as Principal

No member who is a party to a sales agreement referred to in paragraph (c) shall, as principal, purchase any security issued by an open-end management investment company or unit investment trust from a record holder at a price lower than the bid price next quoted by or for the issuer.

(j) Repurchase from Dealer

No member who is a principal underwriter of a security issued by an open-end investment company or a closed-end investment company that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company [1940] Act and offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) under the Securities Act [of 1933] shall repurchase such security, either as principal or as agent for the issuer, from a dealer acting as principal who is not a party to a sales agreement

with a principal underwriter, nor from any investor, unless such dealer or investor is the record owner of the security so tendered for repurchase. No member who is a principal underwriter shall participate in the offering or in the sale of any such security if the issuer voluntarily redeems or repurchases its securities from a dealer acting as principal who is not a party to such a sales agreement nor from any investor, unless such dealer or investor is the record owner of the security so tendered for repurchase. Nothing in this paragraph shall relate to the compulsory redemption of any security upon presentation to the issuer pursuant to the terms of the security.

Nothing in this Rule shall prevent any member, whether or not a party to a sales agreement, from selling any such security for the account of a record owner to the underwriter or issuer at the bid price next quoted by or for the issuer and charging the investor to a reasonable charge for handling the transaction, provided that such member discloses to such record owner that direct redemption of the security can be accomplished by the record owner without incurring such charges.

(k) Execution of Investment Company Portfolio Transactions

(1) No member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular investment company or group of investment companies on the basis of brokerage commissions received or expected by such member from any source, including such investment company, or any covered account.

(2) No member shall sell shares of, or act as underwriter for, an investment company, if the member knows or has reason to know that such investment company, or an investment adviser or principal underwriter of the company, has a written or oral agreement or understanding under which the company directs or is expected to direct portfolio securities transactions (or any commission, markup or other remuneration resulting from any such transaction) to a broker or a dealer in consideration for the promotion or sale of shares issued by the company or any other registered investment company.

(3) No member shall, directly or indirectly, demand or require brokerage commissions or solicit a promise of such commissions from any source as a condition to the sale or distribution of shares of an investment company.

(4) No member shall, directly or indirectly, offer or promise to another member, brokerage commissions from any source as a condition to the sale or distribution of shares of an investment company and no member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales of shares of an investment company.

(5) No member shall circulate any information regarding the amount or level of brokerage commissions received by the member from any investment company or covered account to other than management personnel who are required, in the overall management of the member's business, to have access to such information.

(6) No member shall, with respect to such member's activities as underwriter of investment company shares, suggest, encourage, or sponsor any incentive campaign or special sales effort of another member with respect to the shares of any investment company which incentive or sales effort is, to the knowledge or understanding of such underwriter-member, to be based upon, or financed by, brokerage commissions directed or arranged by the underwriter-member.

(7) No member shall, with respect to such member's retail sales or distribution of investment company shares:

(A) provide to salesmen, branch managers or other sales personnel any incentive or additional compensation for the sale of shares of specific investment companies based on the amount of brokerage commissions received or expected from any source, including such investment companies or any covered account. Included in this prohibition are bonuses, preferred compensation lists, sales incentive campaign or contests, or any other method of compensation which provides an incentive to sales personnel to favor or disfavor any investment company or group of investment companies based on brokerage commissions;

(B) recommend specific investment companies to sales personnel, or establish "recommended," "selected," or "preferred" lists of investment companies, regardless of the existence of any special compensation or incentives to favor or disfavor the shares of such company or companies in sales efforts, if such companies are recommended or selected on the basis of brokerage commissions received or expected from any source;

(C) grant to salesmen, branch managers or other sales personnel any participation in brokerage commissions received by such member from portfolio transactions of an investment company whose shares are sold by such member, or from any covered account, if such commissions are directed by, or identified with, such investment company or any covered account; or

(D) use sales of shares of any investment company as a factor in negotiating the price of, or the amount of brokerage commissions to be paid on, a portfolio transaction of an investment company or of any covered account, whether such transaction is executed in the over-the-counter market or elsewhere.

(8) Provided that the member does not violate any of the specific provisions of this paragraph (k), nothing herein shall be deemed to prohibit:

(A) the execution of portfolio transactions of any investment company or covered account by members who also sell shares of the investment company; or

(B) a member from compensating its salesmen and managers based on total sales of investment company shares attributable to such salesmen or managers, whether by use of overrides, accounting credits, or other compensation methods, provided that such compensation is not designed to favor or disfavor sales of shares of particular investment companies on a basis prohibited by this paragraph (k).

(l) Member Compensation

In connection with the sale and distribution of investment company securities:

(1) Except as described below, no associated person of a member shall accept any compensation from anyone other than the member with which the person is associated. This requirement will not prohibit arrangements where a non-member company pays compensation directly to associated persons of the member, provided that:

(A) the arrangement is agreed to by the member;

(B) the member relies on an appropriate rule, regulation, interpretive release, interpretive letter, or “no-action” letter issued by the [Commission] SEC or its staff that applies to the specific fact situation of the arrangement;

(C) the receipt by associated persons of such compensation is treated as compensation received by the member for purposes of FINRA rules [the Rules of the Association]; and

(D) the record[]keeping requirement in paragraph (l)(3) is satisfied.

(2) No member or person associated with a member shall accept any compensation from an offeror which is in the form of securities of any kind.

(3) Except for items described in [sub]paragraphs (l)(5)(A) and (B), a member shall maintain records of all compensation received by the member or its associated persons from offerors. The records shall include the names of the offerors, the names of the associated persons, the amount of cash, and the nature and[, if known, the] value of non-cash compensation received.

(4) (A) No member shall accept any [cash compensation]sales charges or service fees from an offeror unless such compensation is described in a current prospectus of the investment company. When special [cash compensation]sales charges 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. [Prospectus disclosure requirements shall not apply to cash compensation arrangements between:]

[(A) principal underwriters of the same security; and]

[(B) the principal underwriter of a security and the sponsor of a unit investment trust which utilizes such security as its underlying investment.]

(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, must:

(i) disclose that information about an investment company's fees and expenses may be found in the fund's prospectus;

(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; and

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

(C) The disclosure required by subparagraph (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 subparagraph (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 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 subparagraph (B); or

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

(E) The requirements of Rule 2341(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.

(5) 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. Notwithstanding the provisions of [sub]paragraph (l)(1), the following non-cash compensation arrangements are permitted:

(A) Gifts that do not exceed an annual amount per person fixed periodically by FINRA[the Association]¹ 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) the record²keeping requirement in paragraph (l)(3) is satisfied;

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (l)(5)(D);

(iii) 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;

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

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (l)(5)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that:

(i) the member's or non-member's non-cash compensation arrangement, if it includes investment company securities, is based on the total production of associated persons with respect to all investment company securities distributed by the member;

(ii) the non-cash compensation arrangement requires that the credit received for each investment company security is equally weighted;

(iii) 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

(iv) the record[]keeping requirement in paragraph (l)(3) is satisfied.

(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 paragraph (l)(5)(D).

(m) Prompt Payment for Investment Company Shares

(1) Members (including underwriters) that engage in direct retail transactions for investment company shares shall transmit payments received from customers for such shares, which such members have sold to customers, to payees (i.e., underwriters, investment companies or their designated agents) by (A) the end of the third business day following a receipt of a customer's order to purchase such shares or by (B) the end of one business day following receipt of a customer's payment for such shares, whichever is the later date.

(2) Members that are underwriters and that engage in wholesale transactions for investment company shares shall transmit payments for investment company shares, which such members have received from other members, to investment company issuers or their designated agents by the end of two business days following receipt of such payments.

(n) Disclosure of Deferred Sales Charges

In addition to the requirements for disclosure on written confirmations of transactions contained in NASD Rule 2230, if the transaction involves the purchase of shares of an investment company that imposes a deferred sales charge on redemption, such written confirmation shall also include the following legend: "On selling your shares, you may pay a sales charge. For the charge and other fees, see the prospectus." The legend shall appear on the front of a confirmation and in, at least, 8-point type.

(o) Exchange-Traded Funds

Nothing in this Rule shall be deemed to prohibit the trading of an exchange-traded fund on a secondary market or securities exchange at prices other than the exchange-traded fund's current net asset value, provided that such transactions are consistent with applicable SEC rules and orders. For purposes of this paragraph, "exchange-traded fund" means an open-end investment company or unit investment trust registered under the Investment Company Act that either has received an exemptive order from the SEC permitting trading of the investment company's shares at prices other than its current net asset value, or is operating in a manner consistent with SEC rules applicable to registered open-end investment companies or unit investment trusts that trade in the secondary market.

1. The current annual amount fixed by FINRA[the Association] is \$100.

• • • Supplementary Material: — — — — —

.01 "Cash Compensation." Paragraph (b)(1)(C) of this Rule defines "cash compensation" to mean "any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override or cash employee benefit received in connection with the sale and distribution of investment company securities." Paragraph (b)(1)(E) defines "offeror" to include the adviser, fund administrator, and underwriter of an investment company, and certain affiliates. For purposes of this Rule, "cash compensation" includes cash payments commonly known as "revenue sharing" which are typically paid by the investment company's adviser or another affiliate of the investment company in connection with the sale and distribution of the investment company's securities. "Cash compensation" includes these payments whether they are based upon the amount of investment company assets that a member's customers hold, the amount of investment company securities that the member has sold, or any other amount if the payment is related to the sale and distribution of the investment company's securities.

This guidance supersedes all prior guidance with respect to the definition of cash compensation under paragraph (b)(1)(C) or any predecessor rule.

.02 Special Sales Charge or Service Fee Arrangements. Paragraph (l)(4)(A) of this Rule prohibits a member from accepting sales charges or service fees from an offeror unless such compensation is described in the current prospectus of the investment company, and requires additional disclosure for special sales charge or service fee arrangements. This provision requires two levels of disclosure. First, the prospectus must disclose the

sales charges and service fees that are paid to the member. Second, if an offeror does not make sales charges and service fees available on the same terms to all members that distribute the investment company's securities, the prospectus must disclose the details of the special sales charge or service fee arrangement with the member and the identity of the member in its prospectus.

For purposes of this provision, "special sales charge or service fee arrangement" means an arrangement under which a member receives greater sales charges or service fees than other members selling the same investment company securities. For example, if a member receives the full gross sales charge imposed on the sale of investment company securities, while other members selling the same securities receive only a portion of the gross sales charge, the member receiving the full gross charge has entered into a special sales charge or service fee arrangement with an offeror that requires prospectus disclosure. Similarly, if a member receives a cash payout in addition to the regular commission paid on the sale of investment company securities, and other members do not receive this additional cash payout, the member has entered into a special sales charge or service fee arrangement. This disclosure requirement applies even if an offeror would have made the same arrangement available to other members had they requested it. Generally a member should assume it has entered into a special sales charge or service fee arrangement if it is receiving sales charges or service fees from an offeror in addition to the standard dealer reallocation or commission described in an investment company's prospectus, unless the prospectus is clear that this additional compensation is being paid to all members that sell the investment company's securities.

This guidance supersedes all prior guidance with respect to the disclosure of cash compensation arrangements under paragraph (l)(4) or any predecessor rule.

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1 FINRA has proposed to adopt NASD Rule 2820 as FINRA Rule 2320, with minor changes. See Exchange Act Release No. 59762 (Apr. 14, 2009), 74 FR 18269 (Apr. 21, 2009) (Notice of Filing SR-FINRA-2009-023).