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Page 1 of 73

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2005 - 114
Amendment No. 4

Proposed Rule Change by National Association of Securities Dealers

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☐	☑	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

- ☐ 19b-4(f)(1)
- ☐ 19b-4(f)(2)
- ☐ 19b-4(f)(3)
- ☐ 19b-4(f)(4)
- ☐ 19b-4(f)(5)
- ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name	Gary	Last Name	Goldsholle
Title	Vice President and Associate General Counsel		
E-mail	gary.goldsholle@finra.org		
Telephone	(202) 728-8104	Fax	(202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 01/02/2008

By Gary L. Goldsholle
(Name)

Vice President and Associate General Counsel
(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Gary Goldsholle,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend NASD Rule 2810 to address the regulation of compensation, fees and expenses in public offerings of real estate investment trusts and direct participation programs. The purpose of Amendment No. 3 is to address the comments the SEC received in response to the publication of the proposed rule change in the Federal Register[2] and to propose amendments responsive to the comments where appropriate.

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

* * * * *

2810. Direct Participation Programs

(a) No Change.

(b) Requirements

(1) Application

No member or person associated with a member shall participate in a public offering of a direct participation program, [or] a limited partnership rollup transaction or, where expressly provided below, a real estate investment trust as defined in Rule 2340(d)(4) ("REIT"), except in accordance with this paragraph

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1 15 U.S.C. 78s(b)(1).

(b), provided however, this paragraph (b) shall not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program that complies with subparagraph (2)(D).

(2) No Change.

(3) Disclosure

(A) Prior to participating in a public offering of a direct participation program or REIT, a member or person associated with a member shall have reasonable grounds to believe, based on information made available to him by the sponsor through a prospectus or other materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.

(B) through (C) No Change.

(D) Prior to executing a purchase transaction in a direct participation program or a REIT, a member or person associated with a member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program or REIT during the term of the investment[;]. Included in the pertinent facts shall be information regarding whether the sponsor has offered prior programs or REITs in which disclosed in the offering materials was a date or time period at which the program or REIT might be liquidated, and whether the prior program(s) or REIT(s) in fact liquidated on or around that date or

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[2] See Securities Exchange Act Release No. 54118 (July 10, 2006), 71 FR 40569

during the time period. [provided, however, that paragraph (b) shall not apply to an initial or secondary public offering of a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program which complies with subparagraph (2)(D).]

(4) Organization and Offering Expenses

(A) No member or person associated with a member shall underwrite or participate in a public offering of a direct participation program or REIT if the organization and offering expenses are not fair and reasonable, taking into consideration all relevant factors.

(B) In determining the fairness and reasonableness of organization and offering expenses that are deemed to be in connection with or related to the distribution of the public offering for purposes of subparagraph (A) hereof, the arrangements shall be presumed to be unfair and unreasonable if:

(i) organization and offering expenses, as defined in subparagraph (b)(4)(C), in which a member or an affiliate of a member is a sponsor exceed an amount that equals fifteen percent of the gross proceeds of the offering;

[(i)](ii) the total amount of all items of compensation from whatever source, including offering proceeds and "trail commissions" payable to underwriters, broker/dealers, or affiliates thereof, [which are deemed to be in connection with or related to

(July 17, 2006) (proposing SR-NASD-2005-114).

the distribution of the public offering,] exceeds an amount that equals ten percent of the gross proceeds of the offering [currently effective compensation guidelines for direct participation programs published by the Association];[*]

[(ii) organization and offering expenses paid by a program in which a member or an affiliate of a member is a sponsor exceed currently effective guidelines for such expenses published by the Association;**]

(iii) No Change.

(iv) commissions or other compensation are to be paid or awarded either directly or indirectly, to any person engaged by a potential investor for investment advice as an inducement to such advisor to advise the purchaser of interests in a particular program or REIT, unless such person is a registered broker/dealer or a person associated with such a broker/dealer; [or]

(v) the program or REIT provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of the program [units] or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an[d] over-riding royalty interest, a net profits interest, a percentage of revenues, a

reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items; [provided however, that an arrangement which provides for continuing compensation to a member or person associated with a member in connection with a public offering shall not be presumed to be unfair and unreasonable if all of the following conditions are satisfied:]

[a. the continuing compensation is to be received only after each investor in the program has received cash distributions from the program aggregating an amount equal to his cash investment plus a six percent cumulative annual return on his adjusted investment;]

[b. the continuing compensation is to be calculated as a percentage of program cash distributions;]

[c. the amount of continuing compensation does not exceed three percent for each one percentage point that the total of all compensation pursuant to subparagraph (B)(i) received at the time of the offering and at the time any installment payment is made fall below nine percent; provided, however, that in no event shall the amount of continuing compensation exceed 12 percent of program cash distributions; and]

[d. if any portion of the continuing compensation is

to be derived from the limited partners' interest in the program cash distributions, the percentage of the continuing compensation shall be no greater than the percentage of program cash distributions to which limited partners are entitled at the time of the payment.]

(vi) the program or REIT charges a sales load or commission on securities that are purchased through the reinvestment of dividends, unless the registration statement registering the securities under the Securities Act of 1933 became effective prior to [the effective date of this proposed rule change]; or

(vii) the member has received reimbursement for due diligence expenses that are not included in a detailed and itemized invoice, unless the amount of the reimbursement is included in the calculation of underwriting compensation as a non-accountable expense allowance, which when aggregated with all other such non-accountable expenses, does not exceed three percent of offering proceeds.

(C) The organization and offering expenses subject to the limitations in subparagraph (b)(4)(B)(i) above include the following:

(i) issuer expenses, including overhead expenses that are reimbursed or paid for with offering proceeds, which include, but are not limited to, expenses for:

a. assembling, printing and mailing offering materials, processing subscription agreements, generating advertising and sales materials;

b. legal and accounting services provided to the sponsor or issuer;

c. salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the sponsor or issuer;

d. transfer agents, escrow holders depositories, engineers and other experts, and

e. registration and qualification of securities under federal and state law, including taxes and fees and NASD fees;

(ii) underwriting compensation, which includes but is not limited to items of compensation listed in Rule 2710(c)(3) including payments:

a. to any wholesaling or retailing firm that is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities;

b. to any registered representative of a member who receives transaction-based compensation in connection with the offering;

c. to any registered representative who is engaged

in the solicitation, marketing, distribution or sales of the program or REIT securities, other than one whose functions in connection with the offering are solely and exclusively clerical or ministerial; or

d. for training and education meetings, legal services provided to a member in connection with the offering, advertising and sales material generated by the member and contributions to conferences and meetings held by non-affiliated members for their registered representatives.

(iii) due diligence expenses incurred when a member affirmatively discharges its responsibilities to ensure that all material facts pertaining to a program or REIT are adequately and accurately disclosed in the offering document.

(D) Notwithstanding subparagraphs (b)(4)(C)(ii)b. and c. above, information may be provided to NASD from which the Corporate Financing Department can readily determine that some portion of a registered representative's non-transaction based compensation should not be deemed to be underwriting compensation if the registered representative is either: a dual employee of a program or REIT with fewer than ten people engaged in wholesaling; or a dual employee who is one of the top ten highest paid executives based on non-transaction based compensation in any program or REIT.

[(C)](E) All items of compensation paid by the program or REIT directly or indirectly from whatever source to underwriters, brokers/dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or related to the public offering, shall be taken into consideration in computing the amount of compensation for purposes of determining compliance with the provisions of subparagraphs (A) and (B).

[(D)](F) The determination of whether compensation paid to underwriters, broker/dealers, or affiliates thereof is in connection with or related to a public offering, for purposes of this subparagraph (4), shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the member or affiliate in the organization, management and direction of the enterprise in which the sponsor is involved.

(i) An affiliate of a member which acts or proposes to act as a general partner, associate general partner, or other sponsor of a program or REIT shall be presumed to be bearing investment risk for purposes of this paragraph (b) if the affiliate:

a. through b. No Change.

c. has a net worth equal to at least five percent of the net proceeds of the public offering or $1.0 million, whichever is less; provided, however, that the computation of the net worth shall not include an interest in the program offered but may include net worth applied to satisfy the requirements of this paragraph (b) with respect to other programs or REITs; and

d. agrees to maintain net worth as required by subparagraph c. above under its control until the earlier of the removal or withdrawal of the affiliate as a general partner, associate general partner, or other sponsor, or the dissolution of the program or REIT.

(ii) No Change.

[(E)](G) Subject to the limitations on direct and indirect non-cash compensation provided under subparagraph [(E)](C), no member shall accept any cash compensation unless all of the following conditions are satisfied:

(i) through (v) No Change.

(5) Valuation for Customer Account Statements

No member may participate in a public offering of direct participation program or REIT securities unless[:]

[(A)] the general partner or sponsor of the program will disclose in each annual report distributed to investors pursuant to Section 13(a) of

the Act a per share estimated value of the direct participation program securities, the method by which it was developed, and the date of the data used to develop the estimated value.

(6) No Change.

(c) Non-Cash Compensation

(1) No Change.

(2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation program or REIT 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) through (B) No Change.

(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) No Change.

(ii) the location is appropriate to the purpose of the meeting, which shall mean a United States[an] office of the offeror or the member holding the meeting, or a facility located in the vicinity of such office, or a United States regional location with respect to meetings of associated persons who work within that region or, with respect to [regional] meetings with direct

participation programs or REITs, a United States location at which a significant or representative asset of the program or REIT is located;

(iii) through (iv) No Change.

(D) through (E) No Change.

(d) No Change.

[* A guideline for underwriting compensation of ten percent of proceeds received, plus a maximum of 0.5% for reimbursement of bona fide diligence expenses was published in Notice to Members 82-51 (October 19, 1982).]

[** A guideline for organization and offering expenses of 15 percent proceeds received was published in Notice to Members 82-51 (October 19, 1982).]

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on January 21, 2004, which authorized the filing of the rule change with the SEC. The Board of Governors of FINRA (then known as NASD) had an opportunity to review the proposed rule change at its meeting on January 22, 2004. No other action by NASD is necessary for the filing of the proposed rule change.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

The effective date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

FINRA is proposing to amend Rule 2810 to address the regulation of compensation, fees and expenses in public offerings of unlisted real estate investment trusts (as defined in Rule 2340(c)(4)) ("REITs") and direct participation programs as defined in Rule 2810(a)(4) ("DPPs") (collectively "Investment Programs").[3] Specifically, the proposed rule change addresses: (1) compensation limitations and the use and allocation of offering proceeds; (2) disclosure regarding the liquidity of prior programs offered by the same sponsor; (3) sales loads on reinvested dividends; and (4) non-cash compensation provisions regarding the appropriate location for training and education meetings.

a. Organization and Offering Expenses

Rule 2810 provides three limitations on compensation and offering expenses ("O & O expenses") in Investment Programs. In the current rule, as interpreted by FINRA compensation guidelines, these expenses are broken down into three categories: "compensation," "due diligence," and "issuer organization and offering expenses." First, compensation payable to underwriters, broker-dealers, or affiliates may not exceed 10 percent of the gross proceeds of the offering, regardless of the source from which it is

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[3] REITs and DPPs that are referred to as "Investment Programs" typically are structured so that several affiliated entities make up the program. The affiliated entities include the sponsor, the trust or limited partnership, and a broker-dealer.

derived. Second, members or independent due diligence firms may be reimbursed for an additional 0.5 percent for bona fide due diligence expenses. And third, total issuer O & O expenses for programs in which the member is affiliated with the program sponsor may not exceed 15 percent of the offering proceeds, including any compensation and due diligence expenses.[4]

For offerings of programs in which the member is affiliated with the sponsor, this allows an additional 4.5 percent for issuer O & O expenses above the 10 percent underwriting compensation and 0.5 percent due diligence expenses.

As discussed below, the proposed rule change makes the Rule more explicit and objective in its treatment of the allocation of certain fees and expenses between issuer O & O expenses and compensation (eliminating the current 0.5 percent limit on due diligence expenses and modifying the limitations pertaining to due diligence expenses).

i. Issuer Expenses

In the Original Proposal, FINRA (then known as NASD) proposed to codify the methodology described in NASD Notice to Members 04-07[5] for allocating O & O

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4 See current Rule 2810(b)(4)(B)(i) and Notice to Members 82-51. This 15 percent limitation on O & O expenses applies only to sponsors that are affiliated with FINRA members, while the 10 percent compensation limitation applies to all DPPs.

5 In Notice to Members 04-07 ("Notice"), FINRA requested comment on a proposed rule change and interpretive policies regarding the allocation of fees and expenses between issuers, sponsors and broker-dealers for Investment Programs in which the sponsors and broker-dealers offering such securities are affiliated. The Notice also addressed due diligence practices and disclosure in connection with Investment Programs as well as the allocation of underwriter compensation and issuer organization and offering expenses. The Notice also proposed prohibiting sales loads on reinvested dividends in Investment Programs and closed-end funds. Finally, the Notice requested comment on two non-cash compensation provisions in Rules 2710(i) and 2810(c): (1) a proposal to amend

expenses between compensation, due diligence and issuer O & O expenses. Under the Original Proposal, issuer O & O expenses would have included: (i) expenses, including overhead expenses, for assembling and mailing offering materials, processing subscription agreements and generating advertising and sales materials; (ii) legal services provided to the sponsor or issuer; and (iii) salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing such services. Also included as part of issuer O & O expenses would have been expenses incurred in connection with transfer agents, escrow holders, depositories, engineers and other experts, and registration and qualification of securities under federal and state law, including taxes and fees and FINRA fees.[6]

Three commenters addressed the proposed treatment of issuer O & O expenses.[7] Two commenters generally supported the proposal.[8] One commenter suggested revising the proposed rule change to clarify that the calculation of issuer expenses would only include those issuer O & O expenses that are reimbursed or paid for with offering proceeds. This commenter believed that this clarification would be consistent with FINRA's longstanding policy to include in the limitations on issuer O & O expenses only those expenses deemed to be in connection with the public offering and reimbursed or

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what would constitute an "appropriate location" for training and education meetings; and (2) the new "equal weighting" and "total production" limitations for internal sales contests. FINRA received 10 comment letters on Notice to Members 04-07. Because the Original Proposal discussed the Notice in detail, this proposal only cites to the Notice when necessary.

6 See Original Proposal amendment to Rule 2810(b)(4)(C)(i).

7 ABA Committee, Massachusetts Securities Division and NASAA.

8 Massachusetts Securities Division and NASAA.

paid for with offering proceeds.[9] The commenter also noted that the issuer's business overhead expenses, such as rent, telephone, insurance and employee benefits are costs generally not related to the public offering of an Investment Program's securities and not paid for from offering proceeds.[10]

In addition, this commenter recommended that, to be consistent with Rule 2710, FINRA should clarify that issuer O & O expenses include printing costs and accountant's fees, which are typically borne by the issuer.[11]

Finally, the commenter suggested that the term "issuer O & O expenses" should be changed to minimize confusion with the O & O expenses for the entire offering, which are capped at an amount that equals fifteen percent of the proceeds of an offering and include: (1) "issuer expenses;" (2) "items of compensation;" and (3) "due diligence expenses."[12]

FINRA agrees that it has been its longstanding policy to include in the limitations on issuer O & O expenses only those expenses deemed to be in connection with the public offering and reimbursed or paid for with offering proceeds. FINRA is amending the proposed rule change to clarify this position[13] and also to clarify that issuer expenses

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9 ABA Committee.

10 Id.

11 Id.

12 Id.

13 Proposed amendment to Rule 2810(b)(4)(c)(i)-(ii).

include expenses related to printing costs and accounting fees.[14]

Finally, FINRA has replaced the term "issuer O & O expenses"[15] with "issuer expenses"[16] to minimize confusion with the term "O & O expenses," which includes (1) issuer expenses; (2) items of compensation; and (3) due diligence expenses.[17]

With these modifications, FINRA is re-proposing in Amendment No. 3 the same amendments regarding issuer expenses that were the subject of the Original Proposal.

ii. Limits on Compensation

As in the Original Proposal, the rule change would clarify that amounts deducted from the offering proceeds or amounts paid to members, underwriters or affiliates as trail commissions over time are to be treated as underwriting compensation.[18] In addition, paragraph (b)(4)(b)(i) of Rule 2810 would be amended to expressly state that all items of compensation shall not exceed "ten percent of the gross proceeds of the offering."[19]

Accordingly, all items of compensation paid from any source, including offering proceeds, partnership assets or management fees, would be subject to a "hard cap" of an

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14 Proposed amendment to Rule 2810(b)(4)(c)(i)(a) (printing costs) and Rule 2810(b)(4)(C)(i)(b) (accounting costs).

15 Original Proposal amendment to Rule 2810(b)(4)(c)(i).

16 Proposed amendment to Rule 2810(b)(4)(C)(i).

17 See generally, proposed amendment to Rule 2810(b)(4)(C).

18 See proposed amendment to Rule 2810(b)(4)(b)(i). The proposed amendment deletes the requirement that the compensation be "deemed to be in connection with or related to the distribution of the public offering." This language has been moved to proposed Rule 2810(b)(4)(B).

19 The ten percent figure currently is FINRA policy and is not in the text of the Rule.

amount that equals ten percent of gross offering proceeds.[20]

The proposed rule also limits total O & O expenses (including all items of compensation) to fifteen percent of gross proceeds in an offering in which a member or an affiliate of a member is a sponsor.[21]

The proposed rule change also would delete paragraph (b)(4)(B)(v)(a) through (d) of Rule 2810 relating to continuing compensation arrangements. Members have not relied on these provisions since their adoption, and the limitations on continuing compensation are included in paragraph (b)(4)(B)(i) of Rule 2810 as proposed to be amended.

iii. Wholesaling and Dual Employees

The Original Proposal's amendments to Rule 2810(b)(4)(C)(ii)(a) would have deemed underwriting compensation to include payments to:

> any wholesaler that is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities and any employee of the wholesaler involved in the solicitation, development, maintenance and monitoring of selling agreements and relationships with broker/dealers and accounts and account holders at broker/dealers[.]

Commenters generally supported the proposal with regard to wholesaling firms engaged in solicitation, marketing or distribution of an Investment Program's securities, but believed that the description of wholesaling activities by an employee of a wholesaler was too broad and included clerical and administrative functions in connection with the

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20 Proposed amendment to Rule 2810(b)(4)(B)(i).

21 Proposed amendment to Rule 2810(b)(4)(B)(ii).

offering that traditionally had not been included as underwriting compensation.[22]

The Original Proposal also would have deemed underwriting compensation to include payments to:

> any employee of a member and any dual employee of a member and the sponsor, issuer or other affiliate who receives transaction-based compensation unless information has been provided to NASD, with regard to a program or REIT with fewer than ten people engaged in wholesaling, from which the Corporate Financing Department can readily conclude that the payments are made as consideration for non-broker/dealer services[.][23]

Two commenters expressed concern that the proposed treatment of payments to dual employees who receive transaction-based compensation was too broad because it failed to take into account situations in which such employees only spend part of their time engaged in marketing, distribution or sales of Investment Program securities.[24]

These commenters suggested an alternative approach of requiring the sponsor to make a good faith allocation for payments to dual employees (i.e., employees of a sponsor of an Investment Program and its affiliated broker-dealer) between underwriting compensation and non-distribution related expenses, so that only the allocable portion of a dual employee's transaction-based compensation would be included in the calculation of underwriting compensation.[25]

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22 ABA Committee, IPA and NASAA. NASAA and the Massachusetts Securities Division urged the SEC and FINRA (then known as NASD) to bring greater scrutiny to wholesaling activities, including how sponsors contact brokerage personnel.

23 Original Proposal amendment to Rule 2810(b)(4)(C)(ii)(b).

24 ABA Committee and IPA.

25 Id.

These commenters also requested that FINRA exclude from the Rule's underwriting compensation limits payments to those employees that solely perform clerical, administrative or operational functions that generally do not require such persons to be registered as a representative or principal.

FINRA has revised both of these proposed amendments to Rules 2810(b)(4)(C)(ii)(a)-(b) described above in response to these comments. The proposed rule change clarifies that payments to wholesaling or retailing firms engaged in solicitation, marketing, distribution or sales of Investment Program securities will be included in the underwriting compensation limits.[26]

The Original Proposal would have included payments to employees engaged in wholesaling, regardless of whether they are registered. In general, employees who engage in wholesaling would be required to be registered as representatives under Rule 1031.[27]

Accordingly, as described below, FINRA has amended the proposed rule change so that only payments to employees who are registered persons would be included in the underwriting compensation limits.

First, FINRA has revised the proposed rule change to include as underwriting compensation all payments to a registered representative (including a dual employee) that receives transaction-based compensation in connection with the sale or distribution of

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26 Proposed amendment to Rule 2810(b)(4)(C)(ii)(a).

27 If in the course of reviewing an offering of an Investment Program, the Corporate Financing Department believes that an individual is not properly registered, it will refer such matter to the Member Regulation or Enforcement Departments for further review.

Investment Program securities, subject to two exceptions for small companies and top executives discussed below.[28]

Second, with regard to payments to registered representatives who do not receive transaction-based compensation in connection with the sale or distribution of Investment Program securities, the proposed rule change would treat as underwriting compensation payments to employees who are engaged in the solicitation, marketing, distribution or sales of the Investment Program securities, except individuals whose functions in connection with the offering are solely and exclusively clerical or ministerial.[29]

While commenters suggested an alternative approach of requiring the sponsor or affiliate to make a good faith allocation of payments to dual-employees between underwriting compensation and issuer expenses, FINRA believes the approach described above would be clearer and easier to administer, and would promote more consistency with the application of the Rule among Investment Programs. Investment Programs should easily be able to ascertain whether a registered person's activities involve solicitation, marketing, distribution or sales of the Investment Program securities, and whether those activities are conducted solely and exclusively in a clerical or ministerial

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28 Proposed amendment to Rule 2810(b)(4)(C)(ii)(b). If a dual employee receives compensation for services provided in connection with more than one public offering, or for private placements in addition to offerings of Investment Programs, payments to such employees may be reasonably allocated between the offerings based on the time periods in which the employee was engaged in the offerings, if they are distinct, or based on the relative size of the offerings.

29 Proposed amendment to Rule 2810(b)(4)(C)(ii)(c). Notwithstanding the exemption in Rule 1060(a)(1) and the proposed amendment to Rules 2810(b)(4)(C)(ii)(b)-(c) discussed above, certain persons whose functions are solely and exclusively clerical or ministerial may choose to be registered as representatives. See Rule 1031(a).

capacity. Moreover, this approach should minimize the opportunity for an Investment Program to mischaracterize dual employees' day-to-day activities or to make allocations that are inconsistent with industry standards.[30]

FINRA proposed to modify and improve upon the burdensome process involved when its Corporate Financing Department ("Department") reviews Investment Programs for compliance with the compensation guidelines by analyzing information about job functions, time spent on those functions, and compensation paid to dual employees whose job functions include conducting a securities business. Commenters on Notice to Members 04-07 urged FINRA to continue to utilize the detailed job function analysis in its review of compensation associated with smaller Investment Programs, for which registered representatives are more likely to work in both the securities business and operations and administration. Accordingly, the Original Proposal also provided that Investment Programs with fewer than ten people engaged in wholesaling could provide detailed per-employee information to the Department for its review. Based on its review, the Department could conclude that certain salary or other non-transaction-based payments made to the employee will be allocated to issuer expenses, notwithstanding the fact that the employee also received transaction-based compensation or spent allocable portions of time engaged in securities business activities.[31]

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30 Under the alternative approach suggested by the ABA Committee and IPA, an Investment Program that misallocated payments to dual employees to issuer expenses instead of underwriting compensation would, compared to its competitors, have more offering proceeds available under the compensation limits to market and sell its securities.

31 Original Proposal amendment to Rule 2810(4)(C)(ii)(b).

Commenters supported the treatment of smaller Investment Programs[32] and the proposed rule change includes these provisions. Many Investment Programs' top executives are registered persons who engage in multiple job functions among the program sponsor, wholesaler, property or equipment manager, and portfolio manager. FINRA believes that the Department can conduct an accurate and efficient review of this small group of individuals, whose job functions should be relatively easy to identify and evaluate given their level of prominence within an Investment Program. Accordingly, in response to comments, FINRA also is amending the Original Proposal to include the same job function analysis for any dual employee that is one of the ten highest paid executives in an Investment Program, based on his or her non-transaction-based compensation.[33]

iv. Training and Education Meetings, Legal Services, and Advertising and Sales Materials

The Original Proposal would have allocated to underwriting compensation fees and payments for training and education meetings, legal services provided to a broker-dealer participating in the offering and advertising and sales material generated by a broker-dealer participating in the offering.[34] Two commenters supported the proposal, while another commenter recommended technical changes.[35] FINRA has amended this

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32 IPA, Massachusetts Securities Division and NASAA.

33 Proposed amendment to Rule 2810(b)(4)(D).

34 Original Proposal amendment to Rule 2810(b)(4)(C)(iii)(c).

35 NASAA and the Massachusetts Securities Division supported the proposal. The ABA Committee recommended deleting "Legal services" from the proposal because it would be duplicative of NASD Rule 2710(C)(3)(iii).

proposal to include contributions to conferences and meetings held by non-affiliated members for their registered representatives.[36]

v. Due Diligence

The Original Proposal eliminated the 0.5 percent limit on due diligence expenses under Rule 2810 and would have required that due diligence expenses combined with issuer expenses not exceed the limits on O & O expenses in Rule 2810(b)(4)(B)(ii).[37] The Original Proposal also would have required that a member not accept any payments or reimbursements for due diligence expenses unless they are included in a detailed and itemized invoice that is presented by the member to the program sponsor or other entity that pays or reimburses due diligence expenses.[38]

Two commenters stated that the proposed rule change should be amended to allow due diligence expense reimbursements without a detailed and itemized invoice, and permit such expenses to be included in the ten percent compensation limitation as a non-accountable expense, which is subject to a limit of up to three percent of the offering proceeds pursuant to NASD Rule 2710(f)(2)(B).[39]

One commenter also requested clarification that any payments for due diligence

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36 Proposed amendment to Rule 2810(b)(4)(C)(ii)(d).

37 Instead, the maximum amount of O & O expenses would remain fifteen percent of the gross proceeds of the offering (which amount would include: (1) issuer expenses; (2) compensation up to the maximum of ten percent of gross proceeds; and (3) due diligence expenses that are supported by a detailed and itemized invoice).

38 Proposed amendment to Rule 2810(b)(4)(B)(vii).

39 ABA Committee and IPA. NASAA and the Massachusetts Securities Division supported the proposal rule change.

expenses that are made pursuant to a detailed and itemized invoice will not be included in the ten percent limit on underwriting compensation.[40]

Rule 2810 permits members to receive compensation up to ten percent of the offering proceeds for services rendered in a distribution. These payments may include un-itemized expense allowances of up to three percent of the offering proceeds. FINRA agrees that it is reasonable to include un-itemized due diligence expenses as part of the underwriting compensation. FINRA, therefore, is amending the proposal to include, as part of underwriting compensation, due diligence reimbursements without a detailed and itemized invoice.[41]

However, any member seeking to include due diligence expense as part of issuer expenses must submit an itemized invoice of their actual costs incurred for bona fide due diligence expenses.[42]

FINRA has re-proposed the elimination the 0.5 percent limit in due diligence expenses.[43]

b. Liquidity Disclosure

Rule 2810(b)(3)(D) currently provides that prior to executing a purchase transaction in a direct participation program, a member or person associated with a

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40 ABA Committee.

41 Proposed amendment to Rule 2810(b)(4)(b)(vii).

42 Nothing in the proposed rule change would prohibit the inclusion of a profit margin in the due diligence expense bill of a firm that has conducted due diligence on behalf of a member and that is not a member or an affiliate of a member. See NASD Notice to Members 86-66 ("Due Diligence Expense Reimbursements in Connection with Direct Participation Programs").

43 See footnote accompanying existing Rule 2810(b)(4)(B)(i).

member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program during the terms of the investment. FINRA is concerned that some investors do not fully appreciate that the liquidation of some sponsors' programs are frequently delayed.

The Original Proposal would have amended Rule 2810(b)(3)(D) to include REITs, and would have required members and their associated persons to inform prospective investors whether the sponsor has offered prior programs for which the prospectus disclosed a date or time period when the program might be liquidated, and whether the prior programs, in fact, liquidated on or around that date or time period. In addition, members selling Investment Programs would be required to disclose to investors whether prior programs offered by the program sponsor were, in fact, liquidated on or during the date or time period disclosed in the prospectuses for those programs. For example, if a sponsor has offered ten prior programs and only two of them liquidated by the date or time period set forth in the prospectus, the member would be required to disclose these facts. Two commenters supported the proposal.[44]

One commenter objected to the proposed liquidity disclosure stating that prospectus disclosure typically includes a warning that the liquidity event or liquidation may be delayed due to market conditions and other factors.[45] In this commenter's view, the liquidity disclosure provision would unfairly characterize all situations in which a liquidity event was delayed as a "failure" or "inappropriate." The commenter also therefore believed that the recordkeeping burdens of the proposal and the unwarranted

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44 NASAA and the Massachusetts Securities Division.

45 ABA Committee.

negative implications of such disclosure outweighed the benefit. The commenter suggested that the proposed liquidity disclosure provision should be adopted by the Commission, rather than FINRA, or if adopted by FINRA, should be limited to apply to Investment Programs that have established fixed dates for the occurrence of a liquidity event or liquidation of the DPP or REIT.

FINRA is not persuaded by the commenter's suggestion that additional disclosure regarding historical liquidity practices necessarily creates "unwarranted negative implications." Rather, FINRA believes that the proposed disclosure requirement will help investors make informed investment decisions based on the facts about a sponsor's liquidity track record. FINRA recognizes that delays in liquidity events may be due to market conditions and other factors beyond the sponsor's control, and that, under certain circumstances, investors ultimately may benefit from delays in liquidity. When these facts are relevant, they can be conveyed in addition to the facts regarding the sponsor's liquidity track record providing investors with a complete picture of liquidity issues.

FINRA also notes that the proposal does not require a member to "characterize" a previous delay in liquidation. Rather, the proposed rule change would require members to inform investors whether the sponsor has previously disclosed a date or time period when prior programs may be liquidated, and whether the programs were in fact liquidated on or around that date or time period. Therefore, FINRA has re-proposed the same amendment to Rule 2810(b)(3)(D) as in the Original Proposal.

c. Sales Loads on Reinvested Dividends

In its Original Proposal, FINRA proposed to amend Rule 2810(b)(4)(B)(vi) to prohibit sales loads on reinvested dividends for Investment Programs after the effective date of this rule filing. Two commenters strongly agreed with FINRA's proposal.[46]

FINRA has re-proposed the same amendment to Rule 2810(b)(4)(B)(vi) as in Original proposal.

d. Non-Cash Compensation Provisions

i. Location of Training and Education Meetings

The proposed rule change would amend the current non-cash compensation rule to provide that an "appropriate location" for training and education meeting may include a location at which a significant or representative Investment Program asset is located. The proposed amendment to Rule 2810(c)(2)(C)(ii) would address the fact that an important part of bona fide training and education meetings for Investment Programs may be inspecting real estate, oil and gas production facilities, and other types of assets that will be held and managed by the program,[47] and would provide that a training and education meeting may include a location at which a "significant or representative" asset is located.

Commenters generally supported this aspect of the proposal;[48] however, one

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46 NASAA and the Massachusetts Securities Division.

47 As discussed above, FINRA proposes to amend Rule 2810 so that the Rule's compensation, disclosure and non-cash compensation provisions expressly govern illiquid REITs (i.e., REITs as defined in Rule 2340(d)(4)). The proposed rule change would not amend the non-cash compensation provisions in Rule 2710, which currently are identical to those in Rule 2810. Accordingly, the non-cash compensation provisions regarding the location of training and education meetings will be different for exchange-traded REITs under Rule 2710 and illiquid REITs under Rule 2810.

48 IPA, NASAA and the Massachusetts Securities Division.

commenter suggested that FINRA explicitly state that the non-cash compensation provision applies to public offerings, and not private placements.[49]

Inasmuch as Rule 2810 by its terms applies only to public offerings, FINRA believes that such additional clarification in this section is unnecessary. FINRA has re-proposed the same amendment to Rule 2810(c)(2) as in the Original Proposal.

ii. Total Production and Equal Weighting Requirements

In the Original Proposal, FINRA stated that it was considering future amendments to Rule 2810 to incorporate the total production and equal weighting conditions for internal sales contests in its Investment Company Rule (Rule 2820) and Variable Contracts Rule (Rule 2830) in the context of a broader non-cash compensation rulemaking initiative.[50]

Two commenters urged FINRA to abolish sales contests because they create incentives that are contrary to the obligations broker-dealers have to their customers, such as fair dealing.[51] As noted above, FINRA will consider these issues in future rulemaking.

e. Effective Date of the Proposed Rule Change

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

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49 IPA (noting that it understands from conversations with FINRA (then known as NASD) staff that the non-cash compensation rules are not intended to apply to private placements).

50 See Notice to Members 05-40.

51 NASAA and the Massachusetts Securities Division.

The effective date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[52] which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change would codify FINRA's longstanding policy of applying certain regulatory requirements in Rule 2810 to REITs. In context of Investment Programs, FINRA believes that clarifying the standards for determining the fairness and reasonableness of compensation, treating the use and allocation of offering proceeds in a more explicit and objective manner, requiring disclosure regarding the liquidity of prior programs offered by the same sponsor, prohibiting sales loads on reinvested dividends and enabling bona fide training and education meetings to take place at appropriate locations, are measures designed to prevent fraudulent practices, promote just and equitable principles of trade, and protect investors and the public interest.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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[52] 15 U.S.C. 78o–3(b)(6).

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Commission published the proposed rule change in the Federal Register on July 17, 2006.[53] The comment period closed on August 7, 2006. The Commission received six comments in response to the Federal Register publication of the proposal. The comments are summarized in Item 3a above.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[54]

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

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53 See Securities Exchange Act Release No. 54118 (July 10, 2006), 71 FR 40569 (July 17, 2006) (proposing SR-NASD-2005-114).

54 15 U.S.C. 78s(b)(2).

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 4. Full text of rule change marking changes from Amendment No. 3 to Amendment No. 4. Amendment No. 4 replaces and supersedes in its entirety Amendment No. 3.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2005-114)

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to the Regulation of Compensation, Fees and Expenses in Public Offerings of Real Estate Investment Trusts and Direct Participation Programs

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on September 28, 2005, Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission"), and amended on June 8, 2006,[3] April 16, 2007[4] and November 9, 2007,[5] the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. On , FINRA filed Amendment No. 4 to the proposed rule change.[6] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Amendment No. 1 to SR-NASD-2005-114 replaced and superseded the original rule filing.

4 Amendment No. 2 to SR-NASD-2005-114.

5 Amendment No. 3 to SR-NASD-2005-114 replaced and superseded Amendment No. 2.

6 Amendment No. 4 to SR-NASD-2005-114 replaced and superseded Amendment No. 3.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend NASD Rule 2810 to address the regulation of compensation, fees and expenses in public offerings of real estate investment trusts and direct participation programs. The purpose of Amendment No. 4 is to address the comments the SEC received in response to the publication of the proposed rule change in the Federal Register and to propose amendments responsive to the comments where appropriate. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

2810. Direct Participation Programs

(a) No Change.

(b) Requirements

(1) Application

No member or person associated with a member shall participate in a public offering of a direct participation program, [or] a limited partnership rollup transaction or, where expressly provided below, a real estate investment trust as defined in Rule 2340(d)(4) ("REIT"), except in accordance with this paragraph (b), provided however, this paragraph (b) shall not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program that complies with subparagraph (2)(D).

(2) No Change.

(3) Disclosure

(A) Prior to participating in a public offering of a direct participation program or REIT, a member or person associated with a member shall have reasonable grounds to believe, based on information made available to him by the sponsor through a prospectus or other materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.

(B) through (C) No Change.

(D) Prior to executing a purchase transaction in a direct participation program or a REIT, a member or person associated with a member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program or REIT during the term of the investment[;]. Included in the pertinent facts shall be information regarding whether the sponsor has offered prior programs or REITs in which disclosed in the offering materials was a date or time period at which the program or REIT might be liquidated, and whether the prior program(s) or REIT(s) in fact liquidated on or around that date or during the time period. [provided, however, that paragraph (b) shall not apply to an initial or secondary public offering of a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program which complies with subparagraph (2)(D).]

(4) Organization and Offering Expenses

(A) No member or person associated with a member shall underwrite or participate in a public offering of a direct participation program or REIT if the organization and offering expenses are not fair and reasonable, taking into consideration all relevant factors.

(B) In determining the fairness and reasonableness of organization and offering expenses that are deemed to be in connection with or related to the distribution of the public offering for purposes of subparagraph (A) hereof, the arrangements shall be presumed to be unfair and unreasonable if:

(i) organization and offering expenses, as defined in subparagraph (b)(4)(C), in which a member or an affiliate of a member is a sponsor exceed an amount that equals fifteen percent of the gross proceeds of the offering;

[(i)](ii) the total amount of all items of compensation from whatever source, including offering proceeds and "trail commissions" payable to underwriters, broker/dealers, or affiliates thereof, [which are deemed to be in connection with or related to the distribution of the public offering,] exceeds an amount that equals ten percent of the gross proceeds of the offering [currently effective compensation guidelines for direct participation programs published by the Association];[*]

[(ii) organization and offering expenses paid by a program

in which a member or an affiliate of a member is a sponsor exceed currently effective guidelines for such expenses published by the Association;**]

(iii) No Change.

(iv) commissions or other compensation are to be paid or awarded either directly or indirectly, to any person engaged by a potential investor for investment advice as an inducement to such advisor to advise the purchaser of interests in a particular program or REIT, unless such person is a registered broker/dealer or a person associated with such a broker/dealer; [or]

(v) the program or REIT provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of the program [units] or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an[d] over-riding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items; [provided however, that an arrangement which provides for continuing compensation to a member or person

associated with a member in connection with a public offering shall not be presumed to be unfair and unreasonable if all of the following conditions are satisfied:]

[a. the continuing compensation is to be received only after each investor in the program has received cash distributions from the program aggregating an amount equal to his cash investment plus a six percent cumulative annual return on his adjusted investment;]

[b. the continuing compensation is to be calculated as a percentage of program cash distributions;]

[c. the amount of continuing compensation does not exceed three percent for each one percentage point that the total of all compensation pursuant to subparagraph (B)(i) received at the time of the offering and at the time any installment payment is made fall below nine percent; provided, however, that in no event shall the amount of continuing compensation exceed 12 percent of program cash distributions; and]

[d. if any portion of the continuing compensation is to be derived from the limited partners' interest in the program cash distributions, the percentage of the continuing compensation shall be no greater than the

percentage of program cash distributions to which limited partners are entitled at the time of the payment.]

(vi) the program or REIT charges a sales load or commission on securities that are purchased through the reinvestment of dividends, unless the registration statement registering the securities under the Securities Act of 1933 became effective prior to [the effective date of this proposed rule change]; or

(vii) the member has received reimbursement for due diligence expenses that are not included in a detailed and itemized invoice, unless the amount of the reimbursement is included in the calculation of underwriting compensation as a non-accountable expense allowance, which when aggregated with all other such non-accountable expenses, does not exceed three percent of offering proceeds.

(C) The organization and offering expenses subject to the limitations in subparagraph (b)(4)(B)(i) above include the following:

(i) issuer expenses, including overhead expenses that are reimbursed or paid for with offering proceeds, which include, but are not limited to, expenses for:

a. assembling, printing and mailing offering materials, processing subscription agreements, generating

advertising and sales materials;

b. legal and accounting services provided to the sponsor or issuer;

c. salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the sponsor or issuer;

d. transfer agents, escrow holders depositories, engineers and other experts, and

e. registration and qualification of securities under federal and state law, including taxes and fees and NASD fees;

(ii) underwriting compensation, which includes but is not limited to items of compensation listed in Rule 2710(c)(3) including payments:

a. to any wholesaling or retailing firm that is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities;

b. to any registered representative of a member who receives transaction-based compensation in connection with the offering;

c. to any registered representative who is engaged in the solicitation, marketing, distribution or sales of the

program or REIT securities, other than one whose functions in connection with the offering are solely and exclusively clerical or ministerial; or

d. for training and education meetings, legal services provided to a member in connection with the offering, advertising and sales material generated by the member and contributions to conferences and meetings held by non-affiliated members for their registered representatives.

(iii) due diligence expenses incurred when a member affirmatively discharges its responsibilities to ensure that all material facts pertaining to a program or REIT are adequately and accurately disclosed in the offering document.

(D) Notwithstanding subparagraphs (b)(4)(C)(ii)b. and c. above, information may be provided to NASD from which the Corporate Financing Department can readily determine that some portion of a registered representative's non-transaction based compensation should not be deemed to be underwriting compensation if the registered representative is either: a dual employee of a program or REIT with fewer than ten people engaged in wholesaling; or a dual employee who is one of the top ten highest paid executives based on non-transaction based compensation in any program or REIT.

[(C)](E) All items of compensation paid by the program or REIT directly or indirectly from whatever source to underwriters, brokers/dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or related to the public offering, shall be taken into consideration in computing the amount of compensation for purposes of determining compliance with the provisions of subparagraphs (A) and (B).

[(D)](F) The determination of whether compensation paid to underwriters, broker/dealers, or affiliates thereof is in connection with or related to a public offering, for purposes of this subparagraph (4), shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the member or affiliate in the organization, management and direction of the enterprise in which the sponsor is involved.

(i) An affiliate of a member which acts or proposes to act as a general partner, associate general partner, or other sponsor of a program or REIT shall be presumed to be bearing investment risk for purposes of this paragraph (b) if the affiliate:

a. through b. No Change.

c. has a net worth equal to at least five percent of the net proceeds of the public offering or $1.0 million, whichever is less; provided, however, that the computation of the net worth shall not include an interest in the program offered but may include net worth applied to satisfy the requirements of this paragraph (b) with respect to other programs or REITs; and

d. agrees to maintain net worth as required by subparagraph c. above under its control until the earlier of the removal or withdrawal of the affiliate as a general partner, associate general partner, or other sponsor, or the dissolution of the program or REIT.

(ii) No Change.

[(E)](G) Subject to the limitations on direct and indirect non-cash compensation provided under subparagraph [(E)](C), no member shall accept any cash compensation unless all of the following conditions are satisfied:

(i) through (v) No Change.

(5) Valuation for Customer Account Statements

No member may participate in a public offering of direct participation program or REIT securities unless[:]

[(A)] the general partner or sponsor of the program will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Act a per share estimated value of the direct participation program securities, the method by which it was developed, and the date of the data used to develop the estimated value.

(6) No Change.

(c) Non-Cash Compensation

(1) No Change.

(2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation program or REIT 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) through (B) No Change.

(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) No Change.

(ii) the location is appropriate to the purpose of the meeting, which shall mean a United States[an] office of the offeror or the member holding the meeting, or a facility located in the

vicinity of such office, or a United States regional location with respect to meetings of associated persons who work within that region or, with respect to [regional] meetings with direct participation programs or REITs, a United States location at which a significant or representative asset of the program or REIT is located;

(iii) through (iv) No Change.

(D) through (E) No Change.

(d) No Change.

[* A guideline for underwriting compensation of ten percent of proceeds received, plus a maximum of 0.5% for reimbursement of bona fide diligence expenses was published in Notice to Members 82-51 (October 19, 1982).]

[** A guideline for organization and offering expenses of 15 percent proceeds received was published in Notice to Members 82-51 (October 19, 1982).]

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA is proposing to amend Rule 2810 to address the regulation of compensation, fees and expenses in public offerings of unlisted real estate investment trusts (as defined in Rule 2340(c)(4)) ("REITs") and direct participation programs as defined in Rule 2810(a)(4) ("DPPs") (collectively "Investment Programs").[7] Specifically, the proposed rule change addresses: (1) compensation limitations and the use and allocation of offering proceeds; (2) disclosure regarding the liquidity of prior programs offered by the same sponsor; (3) sales loads on reinvested dividends; and (4) non-cash compensation provisions regarding the appropriate location for training and education meetings.

a. Organization and Offering Expenses

Rule 2810 provides three limitations on compensation and offering expenses ("O & O expenses") in Investment Programs. In the current rule, as interpreted by FINRA compensation guidelines, these expenses are broken down into three categories: "compensation," "due diligence," and "issuer organization and offering expenses." First, compensation payable to underwriters, broker-dealers, or affiliates may not exceed 10 percent of the gross proceeds of the offering, regardless of the source from which it is derived. Second, members or independent due diligence firms may be reimbursed for an additional 0.5 percent for bona fide due diligence expenses. And third, total issuer O &

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[7] REITs and DPPs that are referred to as "Investment Programs" typically are structured so that several affiliated entities make up the program. The affiliated entities include the sponsor, the trust or limited partnership, and a broker-dealer.

O expenses for programs in which the member is affiliated with the program sponsor may not exceed 15 percent of the offering proceeds, including any compensation and due diligence expenses.[8]

For offerings of programs in which the member is affiliated with the sponsor, this allows an additional 4.5 percent for issuer O & O expenses above the 10 percent underwriting compensation and 0.5 percent due diligence expenses.

As discussed below, the proposed rule change makes the Rule more explicit and objective in its treatment of the allocation of certain fees and expenses between issuer O & O expenses and compensation (eliminating the current 0.5 percent limit on due diligence expenses and modifying the limitations pertaining to due diligence expenses).

i. Issuer Expenses

In the Original Proposal, FINRA (then known as NASD) proposed to codify the methodology described in NASD Notice to Members 04-07[9] for allocating O & O

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8 See current Rule 2810(b)(4)(B)(i) and Notice to Members 82-51. This 15 percent limitation on O & O expenses applies only to sponsors that are affiliated with FINRA members, while the 10 percent compensation limitation applies to all DPPs.

9 In Notice to Members 04-07 ("Notice"), FINRA requested comment on a proposed rule change and interpretive policies regarding the allocation of fees and expenses between issuers, sponsors and broker-dealers for Investment Programs in which the sponsors and broker-dealers offering such securities are affiliated. The Notice also addressed due diligence practices and disclosure in connection with Investment Programs as well as the allocation of underwriter compensation and issuer organization and offering expenses. The Notice also proposed prohibiting sales loads on reinvested dividends in Investment Programs and closed-end funds. Finally, the Notice requested comment on two non-cash compensation provisions in Rules 2710(i) and 2810(c): (1) a proposal to amend what would constitute an "appropriate location" for training and education meetings; and (2) the new "equal weighting" and "total production" limitations for internal sales contests. FINRA received 10 comment letters on Notice to

expenses between compensation, due diligence and issuer O & O expenses. Under the Original Proposal, issuer O & O expenses would have included: (i) expenses, including overhead expenses, for assembling and mailing offering materials, processing subscription agreements and generating advertising and sales materials; (ii) legal services provided to the sponsor or issuer; and (iii) salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing such services. Also included as part of issuer O & O expenses would have been expenses incurred in connection with transfer agents, escrow holders, depositories, engineers and other experts, and registration and qualification of securities under federal and state law, including taxes and fees and FINRA fees.[10]

Three commenters addressed the proposed treatment of issuer O & O expenses.[11] Two commenters generally supported the proposal.[12] One commenter suggested revising the proposed rule change to clarify that the calculation of issuer expenses would only include those issuer O & O expenses that are reimbursed or paid for with offering proceeds. This commenter believed that this clarification would be consistent with FINRA's longstanding policy to include in the limitations on issuer O & O expenses only those expenses deemed to be in connection with the public offering and reimbursed or

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Members 04-07. Because the Original Proposal discussed the Notice in detail, this proposal only cites to the Notice when necessary.

10 See Original Proposal amendment to Rule 2810(b)(4)(C)(i).

11 ABA Committee, Massachusetts Securities Division and NASAA.

12 Massachusetts Securities Division and NASAA.

paid for with offering proceeds.[13] The commenter also noted that the issuer's business overhead expenses, such as rent, telephone, insurance and employee benefits are costs generally not related to the public offering of an Investment Program's securities and not paid for from offering proceeds.[14]

In addition, this commenter recommended that, to be consistent with Rule 2710, FINRA should clarify that issuer O & O expenses include printing costs and accountant's fees, which are typically borne by the issuer.[15]

Finally, the commenter suggested that the term "issuer O & O expenses" should be changed to minimize confusion with the O & O expenses for the entire offering, which are capped at an amount that equals fifteen percent of the proceeds of an offering and include: (1) "issuer expenses;" (2) "items of compensation;" and (3) "due diligence expenses."[16]

FINRA agrees that it has been its longstanding policy to include in the limitations on issuer O & O expenses only those expenses deemed to be in connection with the public offering and reimbursed or paid for with offering proceeds. FINRA is amending the proposed rule change to clarify this position[17] and also to clarify that issuer expenses

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13 ABA Committee.

14 Id.

15 Id.

16 Id.

17 Proposed amendment to Rule 2810(b)(4)(c)(i)-(ii).

include expenses related to printing costs and accounting fees.[18]

Finally, FINRA has replaced the term "issuer O & O expenses"[19] with "issuer expenses"[20] to minimize confusion with the term "O & O expenses," which includes (1) issuer expenses; (2) items of compensation; and (3) due diligence expenses.[21]

With these modifications, FINRA is re-proposing in Amendment No. 3 the same amendments regarding issuer expenses that were the subject of the Original Proposal.

ii. Limits on Compensation

As in the Original Proposal, the rule change would clarify that amounts deducted from the offering proceeds or amounts paid to members, underwriters or affiliates as trail commissions over time are to be treated as underwriting compensation.[22] In addition, paragraph (b)(4)(b)(i) of Rule 2810 would be amended to expressly state that all items of compensation shall not exceed "ten percent of the gross proceeds of the offering."[23]

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18 Proposed amendment to Rule 2810(b)(4)(c)(i)(a) (printing costs) and Rule 2810(b)(4)(C)(i)(b) (accounting costs).

19 Original Proposal amendment to Rule 2810(b)(4)(c)(i).

20 Proposed amendment to Rule 2810(b)(4)(C)(i).

21 See generally, proposed amendment to Rule 2810(b)(4)(C).

22 See proposed amendment to Rule 2810(b)(4)(b)(i). The proposed amendment deletes the requirement that the compensation be "deemed to be in connection with or related to the distribution of the public offering." This language has been moved to proposed Rule 2810(b)(4)(B).

23 The ten percent figure currently is FINRA policy and is not in the text of the Rule.

Accordingly, all items of compensation paid from any source, including offering proceeds, partnership assets or management fees, would be subject to a "hard cap" of an amount that equals ten percent of gross offering proceeds.[24]

The proposed rule also limits total O & O expenses (including all items of compensation) to fifteen percent of gross proceeds in an offering in which a member or an affiliate of a member is a sponsor.[25]

The proposed rule change also would delete paragraph (b)(4)(B)(v)(a) through (d) of Rule 2810 relating to continuing compensation arrangements. Members have not relied on these provisions since their adoption, and the limitations on continuing compensation are included in paragraph (b)(4)(B)(i) of Rule 2810 as proposed to be amended.

iii. Wholesaling and Dual Employees

The Original Proposal's amendments to Rule 2810(b)(4)(C)(ii)(a) would have deemed underwriting compensation to include payments to:

> any wholesaler that is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities and any employee of the wholesaler involved in the solicitation, development, maintenance and monitoring of selling agreements and relationships with broker/dealers and accounts and account holders at broker/dealers[.]

Commenters generally supported the proposal with regard to wholesaling firms engaged in solicitation, marketing or distribution of an Investment Program's securities, but believed that the description of wholesaling activities by an employee of a wholesaler

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[24] Proposed amendment to Rule 2810(b)(4)(B)(i).

[25] Proposed amendment to Rule 2810(b)(4)(B)(ii).

was too broad and included clerical and administrative functions in connection with the offering that traditionally had not been included as underwriting compensation.[26]

The Original Proposal also would have deemed underwriting compensation to include payments to:

> any employee of a member and any dual employee of a member and the sponsor, issuer or other affiliate who receives transaction-based compensation unless information has been provided to NASD, with regard to a program or REIT with fewer than ten people engaged in wholesaling, from which the Corporate Financing Department can readily conclude that the payments are made as consideration for non-broker/dealer services[.][27]

Two commenters expressed concern that the proposed treatment of payments to dual employees who receive transaction-based compensation was too broad because it failed to take into account situations in which such employees only spend part of their time engaged in marketing, distribution or sales of Investment Program securities.[28]

These commenters suggested an alternative approach of requiring the sponsor to make a good faith allocation for payments to dual employees (i.e., employees of a sponsor of an Investment Program and its affiliated broker-dealer) between underwriting compensation and non-distribution related expenses, so that only the allocable portion of

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[26] ABA Committee, IPA and NASAA. NASAA and the Massachusetts Securities Division urged the SEC and FINRA (then known as NASD) to bring greater scrutiny to wholesaling activities, including how sponsors contact brokerage personnel.

[27] Original Proposal amendment to Rule 2810(b)(4)(C)(ii)(b).

[28] ABA Committee and IPA.

a dual employee's transaction-based compensation would be included in the calculation of underwriting compensation.[29]

These commenters also requested that FINRA exclude from the Rule's underwriting compensation limits payments to those employees that solely perform clerical, administrative or operational functions that generally do not require such persons to be registered as a representative or principal.

FINRA has revised both of these proposed amendments to Rules 2810(b)(4)(C)(ii)(a)-(b) described above in response to these comments. The proposed rule change clarifies that payments to wholesaling or retailing firms engaged in solicitation, marketing, distribution or sales of Investment Program securities will be included in the underwriting compensation limits.[30]

The Original Proposal would have included payments to employees engaged in wholesaling, regardless of whether they are registered. In general, employees who engage in wholesaling would be required to be registered as representatives under Rule 1031.[31]

Accordingly, as described below, FINRA has amended the proposed rule change so that only payments to employees who are registered persons would be included in the underwriting compensation limits.

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29 Id.

30 Proposed amendment to Rule 2810(b)(4)(C)(ii)(a).

31 If in the course of reviewing an offering of an Investment Program, the Corporate Financing Department believes that an individual is not properly registered, it will refer such matter to the Member Regulation or Enforcement Departments for further review.

First, FINRA has revised the proposed rule change to include as underwriting compensation all payments to a registered representative (including a dual employee) that receives transaction-based compensation in connection with the sale or distribution of Investment Program securities, subject to two exceptions for small companies and top executives discussed below.[32]

Second, with regard to payments to registered representatives who do not receive transaction-based compensation in connection with the sale or distribution of Investment Program securities, the proposed rule change would treat as underwriting compensation payments to employees who are engaged in the solicitation, marketing, distribution or sales of the Investment Program securities, except individuals whose functions in connection with the offering are solely and exclusively clerical or ministerial.[33]

While commenters suggested an alternative approach of requiring the sponsor or affiliate to make a good faith allocation of payments to dual-employees between underwriting compensation and issuer expenses, FINRA believes the approach described above would be clearer and easier to administer, and would promote more consistency with the application of the Rule among Investment Programs. Investment Programs

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32 Proposed amendment to Rule 2810(b)(4)(C)(ii)(b). If a dual employee receives compensation for services provided in connection with more than one public offering, or for private placements in addition to offerings of Investment Programs, payments to such employees may be reasonably allocated between the offerings based on the time periods in which the employee was engaged in the offerings, if they are distinct, or based on the relative size of the offerings.

33 Proposed amendment to Rule 2810(b)(4)(C)(ii)(c). Notwithstanding the exemption in Rule 1060(a)(1) and the proposed amendment to Rules 2810(b)(4)(C)(ii)(b)-(c) discussed above, certain persons whose functions are solely and exclusively clerical or ministerial may choose to be registered as representatives. See Rule 1031(a).

should easily be able to ascertain whether a registered person's activities involve solicitation, marketing, distribution or sales of the Investment Program securities, and whether those activities are conducted solely and exclusively in a clerical or ministerial capacity. Moreover, this approach should minimize the opportunity for an Investment Program to mischaracterize dual employees' day-to-day activities or to make allocations that are inconsistent with industry standards.[34]

FINRA proposed to modify and improve upon the burdensome process involved when its Corporate Financing Department ("Department") reviews Investment Programs for compliance with the compensation guidelines by analyzing information about job functions, time spent on those functions, and compensation paid to dual employees whose job functions include conducting a securities business. Commenters on Notice to Members 04-07 urged FINRA to continue to utilize the detailed job function analysis in its review of compensation associated with smaller Investment Programs, for which registered representatives are more likely to work in both the securities business and operations and administration. Accordingly, the Original Proposal also provided that Investment Programs with fewer than ten people engaged in wholesaling could provide detailed per-employee information to the Department for its review. Based on its review, the Department could conclude that certain salary or other non-transaction-based payments made to the employee will be allocated to issuer expenses, notwithstanding the

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[34] Under the alternative approach suggested by the ABA Committee and IPA, an Investment Program that misallocated payments to dual employees to issuer expenses instead of underwriting compensation would, compared to its competitors, have more offering proceeds available under the compensation limits to market and sell its securities.

fact that the employee also received transaction-based compensation or spent allocable portions of time engaged in securities business activities.[35]

Commenters supported the treatment of smaller Investment Programs[36] and the proposed rule change includes these provisions. Many Investment Programs' top executives are registered persons who engage in multiple job functions among the program sponsor, wholesaler, property or equipment manager, and portfolio manager. FINRA believes that the Department can conduct an accurate and efficient review of this small group of individuals, whose job functions should be relatively easy to identify and evaluate given their level of prominence within an Investment Program. Accordingly, in response to comments, FINRA also is amending the Original Proposal to include the same job function analysis for any dual employee that is one of the ten highest paid executives in an Investment Program, based on his or her non-transaction-based compensation.[37]

iv. Training and Education Meetings, Legal Services, and Advertising and Sales Materials

The Original Proposal would have allocated to underwriting compensation fees and payments for training and education meetings, legal services provided to a broker-dealer participating in the offering and advertising and sales material generated by a broker-dealer participating in the offering.[38] Two commenters supported the proposal,

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35 Original Proposal amendment to Rule 2810(4)(C)(ii)(b).

36 IPA, Massachusetts Securities Division and NASAA.

37 Proposed amendment to Rule 2810(b)(4)(D).

38 Original Proposal amendment to Rule 2810(b)(4)(C)(iii)(c).

while another commenter recommended technical changes.[39] FINRA has amended this proposal to include contributions to conferences and meetings held by non-affiliated members for their registered representatives.[40]

v. Due Diligence

The Original Proposal eliminated the 0.5 percent limit on due diligence expenses under Rule 2810 and would have required that due diligence expenses combined with issuer expenses not exceed the limits on O & O expenses in Rule 2810(b)(4)(B)(ii).[41] The Original Proposal also would have required that a member not accept any payments or reimbursements for due diligence expenses unless they are included in a detailed and itemized invoice that is presented by the member to the program sponsor or other entity that pays or reimburses due diligence expenses.[42]

Two commenters stated that the proposed rule change should be amended to allow due diligence expense reimbursements without a detailed and itemized invoice, and permit such expenses to be included in the ten percent compensation limitation as a non-accountable

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39 NASAA and the Massachusetts Securities Division supported the proposal. The ABA Committee recommended deleting "Legal services" from the proposal because it would be duplicative of NASD Rule 2710(C)(3)(iii).

40 Proposed amendment to Rule 2810(b)(4)(C)(ii)(d).

41 Instead, the maximum amount of O & O expenses would remain fifteen percent of the gross proceeds of the offering (which amount would include: (1) issuer expenses; (2) compensation up to the maximum of ten percent of gross proceeds; and (3) due diligence expenses that are supported by a detailed and itemized invoice).

42 Proposed amendment to Rule 2810(b)(4)(B)(vii).

expense, which is subject to a limit of up to three percent of the offering proceeds pursuant to NASD Rule 2710(f)(2)(B).[43]

One commenter also requested clarification that any payments for due diligence expenses that are made pursuant to a detailed and itemized invoice will not be included in the ten percent limit on underwriting compensation.[44]

Rule 2810 permits members to receive compensation up to ten percent of the offering proceeds for services rendered in a distribution. These payments may include un-itemized expense allowances of up to three percent of the offering proceeds. FINRA agrees that it is reasonable to include un-itemized due diligence expenses as part of the underwriting compensation. FINRA, therefore, is amending the proposal to include, as part of underwriting compensation, due diligence reimbursements without a detailed and itemized invoice.[45]

However, any member seeking to include due diligence expense as part of issuer expenses must submit an itemized invoice of their actual costs incurred for bona fide due diligence expenses.[46]

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43 ABA Committee and IPA. NASAA and the Massachusetts Securities Division supported the proposal rule change.

44 ABA Committee.

45 Proposed amendment to Rule 2810(b)(4)(b)(vii).

46 Nothing in the proposed rule change would prohibit the inclusion of a profit margin in the due diligence expense bill of a firm that has conducted due diligence on behalf of a member and that is not a member or an affiliate of a member. See NASD Notice to Members 86-66 ("Due Diligence Expense Reimbursements in Connection with Direct Participation Programs").

FINRA has re-proposed the elimination the 0.5 percent limit in due diligence expenses.[47]

b. Liquidity Disclosure

Rule 2810(b)(3)(D) currently provides that prior to executing a purchase transaction in a direct participation program, a member or person associated with a member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program during the terms of the investment. FINRA is concerned that some investors do not fully appreciate that the liquidation of some sponsors' programs are frequently delayed.

The Original Proposal would have amended Rule 2810(b)(3)(D) to include REITs, and would have required members and their associated persons to inform prospective investors whether the sponsor has offered prior programs for which the prospectus disclosed a date or time period when the program might be liquidated, and whether the prior programs, in fact, liquidated on or around that date or time period. In addition, members selling Investment Programs would be required to disclose to investors whether prior programs offered by the program sponsor were, in fact, liquidated on or during the date or time period disclosed in the prospectuses for those programs. For example, if a sponsor has offered ten prior programs and only two of them liquidated by the date or time period set forth in the prospectus, the member would be required to disclose these facts. Two commenters supported the proposal.[48]

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47 See footnote accompanying existing Rule 2810(b)(4)(B)(i).

48 NASAA and the Massachusetts Securities Division.

One commenter objected to the proposed liquidity disclosure stating that prospectus disclosure typically includes a warning that the liquidity event or liquidation may be delayed due to market conditions and other factors.[49] In this commenter's view, the liquidity disclosure provision would unfairly characterize all situations in which a liquidity event was delayed as a "failure" or "inappropriate." The commenter also therefore believed that the recordkeeping burdens of the proposal and the unwarranted negative implications of such disclosure outweighed the benefit. The commenter suggested that the proposed liquidity disclosure provision should be adopted by the Commission, rather than FINRA, or if adopted by FINRA, should be limited to apply to Investment Programs that have established fixed dates for the occurrence of a liquidity event or liquidation of the DPP or REIT.

FINRA is not persuaded by the commenter's suggestion that additional disclosure regarding historical liquidity practices necessarily creates "unwarranted negative implications." Rather, FINRA believes that the proposed disclosure requirement will help investors make informed investment decisions based on the facts about a sponsor's liquidity track record. FINRA recognizes that delays in liquidity events may be due to market conditions and other factors beyond the sponsor's control, and that, under certain circumstances, investors ultimately may benefit from delays in liquidity. When these facts are relevant, they can be conveyed in addition to the facts regarding the sponsor's liquidity track record providing investors with a complete picture of liquidity issues.

FINRA also notes that the proposal does not require a member to "characterize" a

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[49] ABA Committee.

previous delay in liquidation. Rather, the proposed rule change would require members to inform investors whether the sponsor has previously disclosed a date or time period when prior programs may be liquidated, and whether the programs were in fact liquidated on or around that date or time period. Therefore, FINRA has re-proposed the same amendment to Rule 2810(b)(3)(D) as in the Original Proposal.

c. Sales Loads on Reinvested Dividends

In its Original Proposal, FINRA proposed to amend Rule 2810(b)(4)(B)(vi) to prohibit sales loads on reinvested dividends for Investment Programs after the effective date of this rule filing. Two commenters strongly agreed with FINRA's proposal.[50]

FINRA has re-proposed the same amendment to Rule 2810(b)(4)(B)(vi) as in Original proposal.

d. Non-Cash Compensation Provisions

i. Location of Training and Education Meetings

The proposed rule change would amend the current non-cash compensation rule to provide that an "appropriate location" for training and education meeting may include a location at which a significant or representative Investment Program asset is located. The proposed amendment to Rule 2810(c)(2)(C)(ii) would address the fact that an important part of bona fide training and education meetings for Investment Programs may be inspecting real estate, oil and gas production facilities, and other types of assets that will be

[50] NASAA and the Massachusetts Securities Division.

held and managed by the program,[51] and would provide that a training and education meeting may include a location at which a "significant or representative" asset is located.

Commenters generally supported this aspect of the proposal;[52] however, one commenter suggested that FINRA explicitly state that the non-cash compensation provision applies to public offerings, and not private placements.[53]

Inasmuch as Rule 2810 by its terms applies only to public offerings, FINRA believes that such additional clarification in this section is unnecessary. FINRA has re-proposed the same amendment to Rule 2810(c)(2) as in the Original Proposal.

ii. Total Production and Equal Weighting Requirements

In the Original Proposal, FINRA stated that it was considering future amendments to Rule 2810 to incorporate the total production and equal weighting conditions for internal sales contests in its Investment Company Rule (Rule 2820) and Variable

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51 As discussed above, FINRA proposes to amend Rule 2810 so that the Rule's compensation, disclosure and non-cash compensation provisions expressly govern illiquid REITs (i.e., REITs as defined in Rule 2340(d)(4)). The proposed rule change would not amend the non-cash compensation provisions in Rule 2710, which currently are identical to those in Rule 2810. Accordingly, the non-cash compensation provisions regarding the location of training and education meetings will be different for exchange-traded REITs under Rule 2710 and illiquid REITs under Rule 2810.

52 IPA, NASAA and the Massachusetts Securities Division.

53 IPA (noting that it understands from conversations with FINRA (then known as NASD) staff that the non-cash compensation rules are not intended to apply to private placements).

Contracts Rule (Rule 2830) in the context of a broader non-cash compensation rulemaking initiative.[54]

Two commenters urged FINRA to abolish sales contests because they create incentives that are contrary to the obligations broker-dealers have to their customers, such as fair dealing.[55] As noted above, FINRA will consider these issues in future rulemaking.

e. Effective Date of the Proposed Rule Change

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[56] which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change would codify FINRA's longstanding policy of applying certain regulatory requirements in Rule 2810 to REITs. In context of Investment Programs, FINRA believes that clarifying the standards for determining the fairness and reasonableness of compensation, treating the use and allocation of offering

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54 See Notice to Members 05-40.

55 NASAA and the Massachusetts Securities Division.

56 15 U.S.C. 78o–3(b)(6).

proceeds in a more explicit and objective manner, requiring disclosure regarding the liquidity of prior programs offered by the same sponsor, prohibiting sales loads on reinvested dividends and enabling bona fide training and education meetings to take place at appropriate locations, are measures designed to prevent fraudulent practices, promote just and equitable principles of trade, and protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Commission published the proposed rule change in the Federal Register on July 17, 2006.[57] The comment period closed on August 7, 2006. The Commission received six comments in response to the Federal Register publication of the proposal. The comments are summarized in Item II above.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

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57 See Securities Exchange Act Release No. 54118 (July 10, 2006), 71 FR 40569 (July 17, 2006) (proposing SR-NASD-2005-114).

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2005-114 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2005-114. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed

with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of FINRA.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2005-114 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[58]

Florence E. Harmon
Deputy Secretary

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[58] 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Full text of proposed rule change marking changes from Amendment No. 3 to Amendment No. 4. Amendment No. 4 replaces and supersedes in its entirety Amendment No. 3. The original changes are shown as if adopted, and the new changes are marked with additions underlined and deletions in brackets.

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2810. Direct Participation Programs

(a) No Change.

(b) Requirements

(1) Application

No member or person associated with a member shall participate in a public offering of a direct participation program, [or] a limited partnership rollup transaction or, where expressly provided below, a real estate investment trust as defined in Rule 2340(d)(4) ("REIT"), except in accordance with this paragraph (b), provided however, this paragraph (b) shall not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program that complies with subparagraph (2)(D).

(2) No Change.

(3) Disclosure

(A) Prior to participating in a public offering of a direct participation program or REIT, a member or person associated with a member shall have reasonable grounds to believe, based on information made available to him by the sponsor through a prospectus or other

materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.

(B) through (D) No Change.

(4) Organization and Offering Expenses

(A) No Change.

(B) In determining the fairness and reasonableness of organization and offering expenses that are deemed to be in connection with or related to the distribution of the public offering for purposes of subparagraph (A) hereof, the arrangements shall be presumed to be unfair and unreasonable if:

(i) organization and offering expenses, as defined in subparagraph (b)(4)(C), in which a member or an affiliate of a member is a sponsor exceed an amount that equals fifteen percent of the gross proceeds of the offering;

[(i)](ii) the total amount of all items of compensation from whatever source, including offering proceeds and "trail commissions" payable to underwriters, broker/dealers, or affiliates thereof, exceeds an amount that equals ten percent of the gross proceeds of the offering;

[(ii) organization and offering expenses, which include all items of compensation, in which a member or an affiliate of a member is a sponsor exceed an amount that equals fifteen percent of the gross proceeds of the offering;]

(iii) through (iv) No Change.

(v) the program or REIT provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of the program [units] or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an over-riding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items;

(vi) through (vii) No Change.

(C) The organization and offering expenses subject to the limitations in subparagraph (b)(4)(B)[(ii)](i) above include the following:

(i) through (iii) No Change.

(D) No Change.

(E) All items of compensation paid by the program or REIT directly or indirectly from whatever source to underwriters, brokers/dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or

related to the public offering, shall be taken into consideration in computing the amount of compensation for purposes of determining compliance with the provisions of subparagraphs (A) and (B).

(F) The determination of whether compensation paid to underwriters, broker/dealers, or affiliates thereof is in connection with or related to a public offering, for purposes of this subparagraph (4), shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the member or affiliate in the organization, management and direction of the enterprise in which the sponsor is involved.

(i) An affiliate of a member which acts or proposes to act as a general partner, associate general partner, or other sponsor of a program or REIT shall be presumed to be bearing investment risk for purposes of this paragraph (b) if the affiliate:

a. through b. No Change.

c. has a net worth equal to at least five percent of the net proceeds of the public offering or $1.0 million, whichever is less; provided, however, that the computation of the net worth shall not include an interest in the program offered but may include net worth applied to satisfy the requirements of this paragraph (b) with respect to other programs or REITs; and

d. agrees to maintain net worth as required by subparagraph c. above under its control until the earlier of

the removal or withdrawal of the affiliate as a general partner, associate general partner, or other sponsor, or the dissolution of the program or REIT.

(ii) No Change.

(G) Subject to the limitations on direct and indirect non-cash compensation provided under subparagraph [(E)](C), no member shall accept any cash compensation unless all of the following conditions are satisfied:

(i) through (v) No Change.

(5) Valuation for Customer Account Statements

No member may participate in a public offering of direct participation program or REIT securities unless[:]

[(A)] the general partner or sponsor of the program will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Act a per share estimated value of the direct participation program securities, the method by which it was developed, and the date of the data used to develop the estimated value.

(6) No Change.

(c) through (d) No Change.

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