SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57803; File No. SR-NASD-2005-114)

May 8, 2008

Self-Regulatory Organizations; National Association of Securities Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.); Order Approving Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 5 Relating to the Regulation of Compensation, Fees and Expenses in Public Offerings of Real Estate Investment Trusts and Direct Participation Programs

I. Introduction

On September 28, 2005, the National Association of Securities Dealers, Inc. ("NASD")[1] filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[2] and Rule 19b-4 thereunder,[3] proposed amendments to NASD Rule 2810. On June 12, 2006, NASD filed Amendment No. 1 to the proposed rule change.[4] The proposed rule change was published for comment in the Federal Register on July 17,

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1 On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Release No. 56146 (July 26, 2007), 72 FR 42190 (Aug. 1, 2007).

2 15 U.S.C. 78s(b)(1).

3 17 CFR 240.19b-4.

4 Amendment No. 1 replaced and superseded the original rule filing.

2006 ("Original Proposal"),[5] and the Commission received six comments.[6]

On April 16, 2007, NASD submitted Amendment No. 2 to the proposed rule change, and on November 9, 2007 and January 2, 2008, FINRA submitted Amendment No. 3 and No. 4, respectively, to the proposed rule change.[7] The Commission published the proposed rule change, as amended, for comment in the Federal Register on January 31, 2008 ("Revised Proposal"),[8] and the Commission received six comments, which are discussed below in Section III.[9] On April 11, 2008, FINRA submitted Amendment No. 5

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

6 See letters from the Committee on Federal Regulation of Securities of the American Bar Association (Keith F. Higgins), dated Aug. 22, 2006; North American Securities Administrators Association (Patricia D. Struck), dated Aug. 11, 2006; Dominion Investor Services, Inc. (Kevin P. Takacs), dated Aug. 7, 2006; Investment Program Association (Rosemarie Thurston), dated Aug. 7, 2006; the Securities Division of Office of the Secretary of the Commonwealth of Massachusetts (Bryan Lantagne), dated Aug. 4, 2006; and Cambridge Legacy Group (Frank Akridge, Jr.), dated Aug. 4, 2006.

7 Each amendment replaced and superseded the earlier amendment. Amendment No. 4 also responded to comments on the Original Proposal.

8 See Securities Exchange Act Release No. 57199 (Jan. 25, 2008), 73 FR 5885 (Jan. 31, 2008) (SR-NASD-2005-114).

9 See letters from R.J. O'Brien Fund Management, LLC (Annette A. Cazenave), dated Apr. 28, 2008 ("R.J. O'Brien"); Michael V. Scillia, ASG Securities, Inc., dated Feb. 24, 2008 ("Scillia"); Committee on Federal Regulation of Securities of the American Bar Association (Keith F. Higgins), dated Feb. 22, 2006 ("ABA Committee"); Snyder Kearney LLC, dated Feb. 21, 2008 ("Snyder"); David Lerner, David Lerner Associates, Inc., dated Feb. 21, 2008 ("Lerner"); and Investment Program Association (Jack L. Hollander), dated Feb. 21, 2006 ("IPA").

to the proposed rule change.[10]

This notice and order solicits comment from interested persons on Amendment No. 5 and approves the proposed rule change, as amended, on an accelerated basis. The text of the proposed rule change is available at www.finra.org, the principal offices of FINRA, and the Commission's Public Reference Room.

II. Description of the Proposed Rule Change

As discussed in more detail in the Original Proposal and Revised Proposal, FINRA is proposing to amend NASD Rule 2810 to address the regulation of compensation, fees and expenses in public offerings of direct participation programs (as defined in NASD Rule 2810(a)(4)) ("DPPs") and unlisted real estate investment trusts (as defined in NASD Rule 2340(d)(4)) ("REITs") (collectively "Investment Programs").[11] 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. The proposed rule change also adds REITs to provisions that already apply to DPPs, but does not make any substantive changes to these sections.[12]

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10 Amendment No. 5 responded to comments on the Revised Proposal and proposed several amendments to the proposed rule change.

11 The DPPs and REITs that comprise 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.

12 See proposed amendments to Rule 2810(b)(3)(A), Rule 2810(b)(4)(A), Rule 2810(b)(4)(B)(v), Rules 2810(b)(4)(D)-(G) and Rule 2810(b)(5). The proposed amendment to Rule 2810(b)(4)(G) also corrects a typographical error by citing "subparagraph (C)," instead of "subparagraph (E)" under the existing rule.

III. Summary of Comments Received and FINRA Response

In Amendment No. 5, FINRA responded to comments on the Revised Proposal and proposed additional amendments to the proposed rule change.

A. Registered Representatives Engaged in de minimis and Incidental Sales Activities

The proposed amendment to Rule 2810(b)(4)(C)(ii)(c) would exclude from the underwriting compensation limit[13] payments to registered representatives, including dual employees, engaged in the solicitation, marketing, distribution or sales of the offering whose functions in connection with that offering are solely and exclusively clerical and ministerial. The IPA suggested that this should be revised to permit a de minimis exception for payments to registered representatives whose functions are predominantly – i.e., at least 95 percent of the employee's time – clerical or ministerial, but who on rare occasions may go beyond performing solely clerical and ministerial functions, such as answering questions.

FINRA stated that the proposed amendment to Rule 2810(b)(4)(C)(ii)(c)(2) was intended to achieve clarity and ease of administration by excluding only those registered representatives whose functions are "solely and exclusively clerical and ministerial." In response to comments, FINRA has amended proposed Rule 2810(b)(4)(C)(ii)(c)(3) to

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13 The underwriting compensation payable to underwriters, broker-dealers, or affiliates may not exceed ten percent of the gross proceeds of the offering, regardless of the source from which the compensation is derived. See current Rule 2810(b)(4)(B)(i) and Notice to Members 82-51. As explained in the Revised Proposal, the ten percent figure currently is FINRA policy. The proposed amendment to Rule 2810(b)(4)(B)(ii) would expressly state that all items of compensation shall not exceed ten percent of the gross proceeds of the offering.

include registered representatives engaged in sales activities provided those activities are "de minimis and incidental to his or her clerical or ministerial functions." However, FINRA stated that it did not intend to adopt a particular metric with respect to this exception, such as percentage of time spent, as it could serve as a tool to evade the purpose and spirit of the rule. FINRA stated that it expected the "de minimis and incidental" exception to be a very narrow one for registered persons whose sales activities are truly incidental to their job functions. FINRA noted that the exception in the proposed amendment to Rule 2810(b)(4)(D) for firms with "ten or fewer registered representatives" engaged in wholesaling is intended to apply to those firms that are most likely to have a need for personnel performing multiple functions.

B. Calculating Items of Underwriting Compensation

Two commenters stated that proposed amendments to Rules 2810(b)(4)(C)(ii)(a)-(c) could result in double counting certain items for purposes of the underwriting compensation limit.[14] For example, these commenters stated that payments received by a member that would be counted as underwriting compensation under the proposed amendment to Rule 2810(b)(4)(C)(ii)(a) would have to be counted again for purposes of the proposed amendments to Rules 2810(b)(4)(C)(ii)(b)-(c) when the member re-allows the payments to its registered representatives.

FINRA responded that it did not intend that items of compensation already required to be counted under proposed amendments to Rule 2810(b)(4)(C)(ii)(a) be double-counted for purposes of the underwriting compensation limit. In response to

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[14] ABA Committee and IPA.

these comments, FINRA has revised the proposed amendments to Rules 2801(b)(4)(C)(ii)(b)-(c).[15]

C. Allocation of Compensation to Dual Employees in Connection With More Than One Offering

Two commenters addressed proposed guidance with respect to allocation of payments to dual employees for purposes of the underwriting compensation limit where the dual employees receive payments for services in connection with more than one offering.[16] Footnote 36 of the Revised Proposal provided guidance ("Guidance")[17] that 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.

The ABA Committee and IPA sought clarification as to whether the Guidance would apply only to dual employees to whom the exceptions from the underwriting compensation set forth in the proposed amendment to Rule 2810(b)(4)(D) are available. FINRA responded that its Corporate Financing Department (the "Department") will

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15 The ABA Committee also requested that the language in the proposed amendment to Rule 2810(b)(4)(B)(ii) be modified slightly to rearrange some commas and clarify that trail commissions are not paid with offering proceeds. FINRA has revised the text accordingly.

16 ABA Committee and IPA.

17 The Guidance appeared in the purpose section of the Revised Proposal and not the proposed rule text.

allocate compensation among multiple offerings with regard to all relevant payments and expenses, not just those for dual employees.

The IPA also stated that the concepts addressed in the Guidance should be incorporated into the proposed amendments to Rule 2810 with general application to payments to dual employees among multiple offerings, not just the exceptions in Proposed Rule 2810(b)(4)(D). The ABA Committee suggested that the Guidance should allow the allocation of the salary of any registered representative.

FINRA responded that it will continue its longstanding practice, with respect to a registered representative receiving compensation for services provided in connection with more than one public offering, or for private placements in addition to offerings of Investment Programs, of allowing payments to such registered representatives to be allocated between the offerings on a reasonable basis taking into account relevant factors, including the time periods spent on particular offerings, the relative sizes of the offerings and the number of investors in each. FINRA noted that, in the course of its review of particular offerings, information and representations by members with respect to such factors will vary. As a result, FINRA determined not to codify these factors and their respective weights in the proposed rule change, but rather will continue its current review practices that permit reasonable basis allocations.

D. Analysis of Employee Compensation

1. Per Employee Analysis In All Investment Programs

The proposed amendment to Rule 2810(b)(4)(D) would have excepted from the underwriting compensation limit, subject to the Department's determination, some

portion of the non-transaction-based payments to a registered representative dual employee of an Investment Program with "fewer than ten people engaged in wholesaling." The ABA Committee suggested that the exception should instead be available to smaller members that have fewer than ten registered representatives engaged in wholesaling with respect to an Investment Program in order to avoid the inclusion of persons who are not registered in the calculation.[18]

The IPA also asked FINRA to clarify the proposed rule to provide that in determining whether there are fewer than ten people engaged in wholesaling, only those persons engaged in wholesaling for a particular Investment Program should be counted, rather than all registered representatives who are employed by a sponsor or affiliate and engaged in wholesaling some other product of the sponsor or affiliate.

The Revised Proposal explained that the Department would engage in the same detailed job function analysis with respect to certain compensation associated with smaller Investment Programs as it would with respect to certain compensation of the ten highest paid executives in any Investment Program. Accordingly, a member could provide detailed per-employee information to the Department from which the Department could conclude that certain salary and other non-transaction-based compensation provided to the employee could be allocated to issuer expenses.

In response to these comments, FINRA has amended the exception to clarify that for every program or REIT filed for review, the Department will engage in the detailed per-employee analysis. The proposed amendment to Rule 2810(b)(4)(D) would apply to

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[18] The ABA Committee also stated that the rule should be amended to clarify that it applies to a dual employee of a "member and the sponsor, issuer or other affiliate."

"ten or fewer registered representatives" engaged in wholesaling if they are dual employees in a smaller Investment Program and to the ten highest paid executives in any Investment Program.[19] FINRA also clarified that the rule would only apply to "ten or fewer registered representatives [of an Investment Program] engaged in wholesaling." FINRA also clarified that the rule applied to a dual employee of a "member and the sponsor, issuer or other affiliate."[20]

The ABA Committee also suggested that the calculation of the number of persons engaged in wholesaling should only include those registered representatives directly contacting other members to solicit new selling agreements with respect to the specific Investment Program. FINRA disagreed. As discussed in the Revised Proposal, the Department expects to conduct accurate and efficient reviews of the individual's job functions to determine whether the exceptions in proposed amendment to Rule 2810(b)(4)(D) would be available. FINRA stated that it does not believe it is useful or appropriate to conduct a two-step analysis of each registered representative's functions (to analyze every registered representative's activities to determine whether ten or fewer were engaged in wholesaling with regard to a specific Investment Program, and then to

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19 The wholesaling exception discussed in the Revised Proposal would have been available to an Investment Program with "fewer than ten people" engaged in wholesaling. In response to comments, FINRA stated that allowing the exception for "ten or fewer" registered representatives rather than "fewer than ten" would be consistent with the goal of clarity and ease of administration.

20 Telephone conversation among Gary Goldsholle, Vice President and Associate General Counsel, FINRA; Joseph Price, Vice President, Corporate Financing, FINRA; Adam Arkel, Assistant General Counsel, FINRA; Lourdes Gonzalez, Assistant Chief Counsel – Sales Practices, Commission; and Michael Hershaft, Special Counsel, Commission (May 7, 2008).

analyze the job functions of up to ten registered representatives to determine what portion of payments to them should be included in the underwriting compensation calculation).

2. Top Ten Executives

The proposed amendment to Rule 2810(b)(4)(D) would except from the underwriting compensation limit, subject to the Department's determination, some portion of the non-transaction-based payments to a registered representative dual employee who is one the top ten highest paid executives based on non-transaction-based compensation in any Investment Program. The ABA Committee sought clarification as to whether the executives to whom this exception would be available must be registered representative dual employees. As discussed above, FINRA has amended the exception to make this clarification.

Two commenters stated that the exception should not require that the dual employees must be executives or have executive titles.[21] Further, both commenters suggested that the top-ten calculation should be based on non-transaction-based compensation "in connection with" an Investment Program.[22]

FINRA responded that the term "executive" is not intended as a formal job designation or title, but rather as a characterization of the registered representative dual employee's role in the Investment Program. As explained in the Revised Proposal, the Department believes that it can identify and evaluate a small group of individuals performing executive job functions within an Investment Program. However, FINRA

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21 ABA Committee and IPA.

22 Id.

disagreed with the suggestion of amending the rule to base the top ten executive calculation on non-transaction-based compensation "in connection with" a particular Investment Program. As with firms with up to ten registered representatives engaged in wholesaling, FINRA does not believe it is useful or appropriate to conduct a two-step analysis for each executive (to determine the extent to which each executive's compensation varies and is attributable to particular programs in order to identify the relevant executives eligible for the exception, and then to determine what portion of payments to them should be included in the underwriting compensation calculation).

E. Issuer Expenses

1. Overhead Expenses

Both the ABA Committee and the IPA stated that the proposed amendment to Rule 2810(b)(4)(C)(i) should be revised to clarify that issuer expenses, not just overhead expenses, that are reimbursed or paid for with offering proceeds must be included for purposes of the cap on organization and offering expenses. FINRA has revised the proposed amendment to Rule 2810(b)(4)(C)(i) to make this clarification.

2. Services for the Issuer

The ABA Committee stated that the proposed amendment to Rule 2810(b)(4)(C)(i)(c) should clearly specify the scope of services provided by employees or agents of the sponsor or issuer that must be included for purposes of the cap on organization and offering expenses. When proceeds of an offering are used to pay issuer expenses, these payments or reimbursements must be identified in filings with the Department. FINRA responded that if the rule limited the scope of payments that could

be made to employees or agents of the sponsor or issuer for performing services for the issuer to only those activities specifically described in the rule, some otherwise legitimate payments or reimbursements using offering proceeds would be prohibited. Accordingly, FINRA has not revised the proposed amendments to Rule 2810(b)(4)(C)(i)(c), other than to clarify that the proposed rule refers to services for the issuer.

F. Liquidity and Marketability Disclosure

The IPA expressed concern that the proposed amendments to Rule 2810(b)(3)(D) would impose upon members a burdensome due diligence review requirement with respect to the liquidity and marketability of an Investment Program. In its response, FINRA recognized the burdens associated with these requirements, but noted that the proposed amendment to Rule 2810(b)(3)(D) is intended to permit members to rely upon the liquidity and marketability information as provided to the member by the sponsor or general partner of an Investment Program, provided that the member does not know or have reason to know that the information is inaccurate. Accordingly, FINRA has not revised the proposed amendment to Rule 2810(b)(3)(D).

G. Reinvested Dividends

One commenter expressed concern regarding the prohibition set forth in the proposed amendment to Rule 2810(b)(4)(B)(vi) against sales loads on reinvested dividends for Investment Programs.[23] After considering the comment, FINRA determined to maintain the prohibition on sales loads on reinvested dividends. FINRA

[23] Lerner.

emphasized that commenters on the Original Proposal supported this amendment[24] and the amendment is intended to conform Rule 2810 to similar changes made to Rule 2830 with respect to sales loads on reinvested dividends for sales of mutual funds. Further, so as to avoid the indirect payment of sales loads on reinvested dividends for Investment Programs, FINRA has amended proposed Rule 2810(b)(4)(B)(ii) to clarify that the calculation of "ten percent of the gross proceeds of the offering" excludes securities purchased through the reinvestment of dividends.

H. Due Diligence Services

One commenter sought guidance as to what levels of detail and itemization, as required by the proposed amendment to Rule 2810(b)(4)(B)(vii), would be appropriate for an invoice prepared by a law firm conducting on behalf of a member due diligence services that are intended to be reimbursed as issuer expenses.[25] FINRA responded that industry best practices may be effective in establishing a threshold for itemization rather than additional rulemaking. The commenter also sought guidance as to whether it would be permissible for the issuer or sponsor to reimburse the law firm directly, so that the member need not go through the extra step of first itself paying the law firm and then seeking reimbursement from the issuer or sponsor.[26] FINRA responded that a law firm could not provide bona fide due diligence in an offering if its client was the issuer or sponsor rather than the broker-dealer. The method of reimbursement for due diligence

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24 Massachusetts Securities Division and NASAA.

25 Snyder.

26 Id.

services should be irrelevant so long as it does not undermine the law firm's duties to its client, the broker-dealer.[27]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 5, including whether Amendment No. 5 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.

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[27] FINRA also addressed two other comments. Scillia suggested that the five percent limitation on issuer expenses that currently exists in NASD Rule 2810 precludes offerings of smaller DPPs. FINRA disagreed with this comment. FINRA stated that the five percent limitation on issuer expenses pertains to the amount that may be used from offering proceeds. An issuer can spend additional funds from other sources. Thus, FINRA believes that the sponsor of a smaller DPP or REIT can absorb the higher fixed overhead costs owing to the small size of the offering. Finally, the five percent limitation on issuer expenses in the proposed rule change is not new and is consistent with the standards in existing NASD Rule 2810, which was approved by the SEC. See email from Gary Goldsholle, Vice President and Associate General Counsel, FINRA, to Michael Hershaft, Special Counsel, Commission (May 7, 2008).

With respect to the letter from R.J. O'Brien, FINRA stated that the comments were beyond the scope of the filing as the proposed rule change does not impose any new requirements with respect to commodity pool trail commissions. The issues raised in this letter were addressed by the SEC in an approval order issued in a prior rulemaking proceeding. See Securities Exchange Act Release No. 50335 (Sept. 9, 2004), 69 FR 55855 (Sept. 16, 2004) (SR-NASD-2004-136). Id.

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].

V. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[28] which require, among other things, that FINRA 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.[29] The Commission notes that the proposed rule change would codify FINRA's longstanding policy of applying certain regulatory requirements in NASD Rule 2810 to REITs.

The Commission 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.

Accelerated Approval of Amendment No. 5

The Commission finds good cause for approving Amendment No. 5 to the proposed rule change prior to the thirtieth day after the amendment is published for comment in the Federal Register pursuant to Section 19(b)(2) of the Act. Amendment No. 5 clarifies several provisions of the proposed rule change, including calculating and

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28 15 U.S.C. 78o–3(b)(6).

29 In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

allocating compensation, requiring issuer compensation to be included in the cap on organization and offering expenses, and providing greater specificity regarding the prohibition on sales loads on reinvested dividends. The Commission believes that these changes will provide greater clarity with respect to the applicability of and compliance with the proposed rule change, while continuing to protect investors and the public interest. Accordingly, the Commission finds that the accelerated approval of Amendment No. 5 is appropriate.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[30] that the proposed rule change, as amended (SR-NASD-2005-114), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[31]

Florence E. Harmon
Deputy Secretary

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30 15 U.S.C. 78s(b)(2).

31 17 CFR 200.30-3(a)(12).