ING

ADVISORS NETWORK

By Electronic Mail

August 4, 2005

Barbara Z. Sweeney
Office of Corporate Secretary
NASD
1735 K Street, NW
Washington, D.C. 20006-1500

Re: Notice to Members 05-40 *Sales Contests and Non-Cash Compensation*

Dear Ms. Sweeney:

Thank you for giving us the opportunity to comment on Notice to Members 05-40 ("Proposal"). ING Advisors Network is the marketing name for a group of retail broker-dealers with a total of over 9,000 representatives.[1] Our representatives are independent contractors and engage in the sales of general securities and packaged products. These comments are submitted on behalf of all of our broker-dealers.

We appreciate NASD's concerns about incentive compensation practices in the securities industry. We also appreciate the fact that NASD's non-cash compensation rules, which began as rules designed to assist members in supervising their representatives, have evolved over the years to become rules more designed to avoid conflicts of interest. During this evolution, the rules have been subject to any number of interpretations because in many respects they have lacked clarity. We respectfully submit that the changes suggested by the Proposal do not make the rules any more clear. Extension of the rules to all securities simply exacerbates this. The current rules need to be made more clear before extending their reach. In addition, the proposed rules relating to "sales contests" will have significant adverse effects on broker-dealers. We also believe that the rules, as proposed, will have anti-competitive effects on the industry.

Of paramount importance to us is that the proposal to disallow future offeror contributions to broker-dealer incentive programs will have costs to broker-dealers that far outweigh any benefit to the public customers. As described more fully below, the Proposal would make it virtually impossible for small and medium-sized broker-dealers to organize and hold training sessions for their representatives on products, processes, marketing and other significant sales issues because these broker-dealers would be forced to bear 100% of the costs of those training meetings and/or have minimal participation by independent contractor representatives. We do not believe that this added costs to broker-dealers and subsequent decline in the number of training meetings would be in the best interests of the investing public.

We offer the following specific comments.[2]

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[1] The broker-dealers include Financial Network Investment Corporation, Multi-Financial Securities Corporation, ING Financial Partners, Inc., and PrimeVest Financial Services, Inc. and its subsidiary broker-dealers.

[2] For simplicity purposes, our comments will cite to current Conduct Rule 2820 for comparison purposes, but the comments are equally applicable to similar provisions in Conduct Rules 2830, 2710 and 2810.

CLARIFICATION OF RULE LANGUAGE IS NEEDED BEFORE EXPANSION OF THE RULES TO ALL SECURITIES

Before any new non-cash compensation rules are enacted, NASD needs to clarify which existing interpretations will still be valid. These interpretations currently exist in Notice to Members 99-55, various Securities Exchange Act releases as well as a number of interpretative letters. We strongly urge the NASD to accompany the rule with an Interpretation that makes clear which of these interpretations will continue to apply and further explains some of the issues described below.

The "In Connection With" Requirement

The existing preamble to Rule 2820(g) uses the term "in connection with the sale and distribution of variable contracts." Proposed Rule 2311 would continue to use this language in the definitions of cash and non-cash compensation. This phrase is unclear and needs better definition. This is particularly important if the rules are expanded to include all securities, including common stock, and the definition of "offeror" expanded to include an issuer of such securities. A number of broker-dealers are owned by public companies.

Under the anti-fraud provisions of the federal securities laws, the phrase "in connection with" has been interpreted very broadly. Such a broad interpretation under the proposed rules would not be appropriate and would cause confusion as to what support, if any, for instance, a public company could give to a subsidiary broker-dealer. In general, the language could be interpreted to prohibit provision by offerors of training materials, advertising and other such items that the NASD has historically permitted. The NASD has previously noted that the phrase was unclear and stated that clarification would be forthcoming.[3] No such clarification has ever been issued and we believe that NASD should do so now.

"Preconditioned on the Achievement of a Sales Target"

We applaud the NASD's attempt to provide clarification to this phrase, which has certainly caused confusion in the industry. We are concerned, however, with using a standard that rests on an associated person's "understanding." This phrase is imprecise. A broker-dealer has limited, if any, control over an associated person's "understanding," and "understandings" tend to change over time. A broker-dealer cannot defend itself against an associated person's assertion that he/she "understood" that a sales target was involved, particularly where the proposal does not include a reasonableness standard. Theoretically, a single associated person's misunderstanding could result in an entire program being found to be in violation of the rules.

We believe that a better standard would be one that focuses on the conduct of the broker-dealer itself. Such a standard could be "an arrangement in which the broker-dealer sets a dollar-denominated goal or a goal of finishing within a defined number of top sellers in advance." This approach would be more consistent with the idea that a broker-dealer can continue to award past performance or encourage future performance as would be permitted by the Proposal.

"Sales Contest"

We believe that a better term would be "incentive arrangement." Many of the incentive programs offered by broker-dealers today include educational meetings that use production as a qualification for attendance or for awarding reduced costs of attendance. Such language would be more easily understood by representatives in the field and other industry persons.

The definition of "sales contest" should be clarified to mean an incentive arrangement based on sales of a specific security or type of security. Incentive programs involving such things as increasing assets under management or opening new accounts, which are currently permissible, should continue to be allowed. The broad language currently proposed could be interpreted to exclude such arrangements.

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[3] *See,* Securities Exchange Act Release No. 37373 (June 26, 1996).

The proposed definition of "sales contest" excludes arrangements based on "total production" of associated persons. How "total production" is to be measured should be clarified either in the rule or in accompanying interpretative material.

The proposed rule would impose recordkeeping requirements on "contests" that are excluded from the definition of "sales contest." Currently, Rule 2830(g)(3) requires recodkeeping of all compensation received from offerors and this makes sense in that it gives a mechanism to ensure that compensation received from offerors is proper under the rules. Expansion of recordkeeping rules to internal broker-dealer "contests" that are excluded from the definition of "sales contest" and would include requiring the names of all associated persons who participated in the "contest" would be unduly burdensome. Further, the term "contest" in this context is not defined.

It should be clarified that sales incentive arrangements may be limited to categories of representatives and should not be required to include all representatives within a broker-dealer. This is particularly important if the rules are to be extended to all securities. For instance, a broker-dealer with both wholesale and retail sales forces should be able to have an incentive program with respect to one and not both.

Other Language in the Proposed Rule

The Proposal states that proposed Rule 2311 would replace Rule 2820(g)(4) for variable contracts and the similar provisions for the other products with similar current rules. However, proposed Rule 2311 contains definitions of "cash compensation" and "non-cash compensation" that differ from the current provisions of the rules that do not appear to be part of the amendment. It is not clear why the definitions are being placed in proposed Rule 2311 and not being suggested as amendments to Rule 2820(b), and similar provisions in the other rules. There are other provisions in current Rule 2820 that reference compensation but are not apparently changing. Having a different definition in Rule 2311 is confusing.

"Cash Compensation" now includes the phrase "cash prize received." It is not clear why this phrase is being added to the definition since the only reference in the proposed rule to "cash" is in the definition of "sales contest" that includes the undefined phrase "cash prizes."

The definition of "sales contest" references "cash or non-cash prizes" and not compensation. This lack of clarity will create confusion. The term "prize" should be fined.

The term "security" that is present throughout proposed Rule 2311 needs definition. Presumably it means securities as defined by Section 3(a) of the Securities Exchange Act.

RESTRICTIONS ON SALES CONTESTS

Prohibition on Product-Specific Sales Contests

The current rules relating to incentive arrangements permit incentives to be based on sales of a single product, subject to the condition that the products within the category are equally weighted. The current rules make sense because decisions as to which manufacturer's product should be sold to a particular customer who is looking to purchase a specific product should be based on factors other than sales incentives. The proposed requirement to base incentive arrangements across products, however, does not make logical sense for the following reasons:

- The rationale presumes that a representative would sell a client a variable annuity when common stock would be more appropriate based on a sales incentive program. The NASD has offered no empirical data to support this presumption. Further, current suitability rules would already preclude such a sale.

- Even assuming that there is some support for the proposition noted above, a sales incentive program based on "total production" of all types of securities does not cure the perceived problem. Different types of securities have significantly different commission structures and cannot be truly equally weighted. Therefore, even under the proposed rule, a representative would have an incentive to sell one type of security over another to generate more production for the sales contest based on the commission structure of the product.[4]

- Not all representatives in a broker-dealer are qualified and registered to sell all products the broker-dealer offers. These representatives either would have to be excluded from any sales incentive program offered by the broker-dealer or, in any event, be engaged in product specific sales incentive programs.

NASD notes as part of its rationale for the proposal that the new rule would prohibit "stock of the day" and similar promotions. However, such promotions could more appropriately be prohibited by application of the equal weighting requirements to these securities that currently exists with respect to variable contracts, mutual funds, and the other securities already subject to such rules. A broker-dealer could not have a "stock of the day" promotion if all stocks were required to be equally weighted.

Prohibition of product-specific sales incentive programs would have anti-competitive effects. Single product broker-dealers would be permitted to hold sales incentive programs that general securities firms could not. Such anti-competitive rulemaking when other alternatives are available would not be appropriate.

ELIMINATION OF PROVISIONS PERMITTING NON-MEMBER AND OTHER MEMBER CONTRIBUTIONS TO NON-CASH ARRANGEMENTS

NASD has requested specific comment on whether there is any need to retain the current provisions allowing contributions by non-members and other members to a non-cash compensation arrangement between a member and its associated persons given the proposed ban on product-specific sales contests. We respectfully submit that elimination of these provisions would have severe negative impacts on the industry.

The only apparent rationale for elimination of these current provisions would be that there is a belief that product sponsors only contribute to incentive programs that are based on sales of their particular products. This, however, is not the case. Offerors often contribute to broker-dealer incentive programs that are based on sales of all products or on factors not specifically related to their specific products.

Current NASD rules allow the following arrangements, subject to certain limitations:

1. Non-cash arrangements between a broker-dealer and an affiliated offeror, such as an insurance company

2. contributions by non-affiliated offerors as long as those offerors do not participate in the organization of the meeting

3. contributions by the member to non-member incentive programs, such as a broker-dealer's contributions to a bank program.

NASD should not render these activities impermissible for the reasons set forth below.

Insurance Companies and Affiliated Broker-Dealers

[4] We are aware that even products within a specific category pay different commissions. One mutual fund, for example, may pay a higher commission than another similar fund. However, these differences are not as dramatic within a product category as they are across product lines.

The NASD previously addressed this issue when it proposed the rules that are currently in effect.[5] At that time, the NASD appropriately noted that insurance companies hold sales incentive programs for their sales persons who are also associated persons of an affiliated broker-dealer and are licensed to sell both non-securities and securities insurance products. Sales of both variable products and fixed products are often part of the total compensation package for these individuals. Whether the relationship of the salesperson to the insurance company is that of employee, statutory employee, independent contractor or independent insurance agent, the NASD previously refused to interfere with these relationships and should not do so now.

Of particular concern is that the broad language of the proposed rule would appear to preclude even bonuses paid to employees by corporations who own product manufacturers and broker-dealers where the bonuses are based, in whole or in part, on sales of proprietary products within a specific time frame. This prohibition would appear to apply even to employees who do not sell securities but who are registered with broker-dealers and for whom there are no point of sale conflicts. If the rules are intended to cover these situations, the rules represent an unwarranted intrusion by the NASD into employer-employee relationships of a large number of corporations (or discourage the ownership of broker-dealers by offerors which is not, and should not become, one of the purposes of the Rule) without any stated rationale. If the rules are not intended to apply to these situations, the rules need to specifically exclude these arrangements.

Further, the broad language of the rule is contrary to the statement by the NASD that the rule would not apply to a member that, on an ongoing basis, pays out to associated persons a higher commission on proprietary products where the member determines to cease the higher payments and provides any kind of advanced notice to its representatives. By notifying its sale force that higher payments would cease at a specific date in the future, the member would be setting a "defined period of time," which would appear to cause the higher payout to come under the definition of "sales contest" at that time. Such a result would not be appropriate, nor would a requirement that no advance notice could be given to representatives.

Non-affiliated Offeror Contributions

Prohibiting non-affiliated offerors' contributions to a broker-dealer's sales incentive program would have disastrous consequences, particularly for independent contractor broker-dealers. Many broker-dealers, particularly small and medium-sized firms, offer any number of sales meetings during the course of a year that provide important educational opportunities not otherwise available for independent contractor representatives. These sales meetings are often sales incentive in nature in that they reward higher producing representatives by paying all or a portion of the costs of attending the meeting. At other times, broker-dealers hold meetings for their top producers who usually account for the vast majority of total sales. Small and medium-sized broker-dealers are not in a financial position to pay for representatives that are lower producers. Because there are incentive aspects to these meetings, they do not qualify under the rules relating to training and educational meetings and there is no other apparent exception to the ban on receipt of non-cash compensation as proposed.

These incentive meetings represent important opportunities to offer independent contractor representatives education and training in products, operations, technology, regulatory issues and a number of other topics important to the conduct of their business. They provide these individuals with opportunities to network and exchange ideas. These opportunities would not be available to independent contractor representatives if they were forced to pay for such programs with their own funds.

Small and medium-sized broker-dealers generally cannot afford to pay for these meetings without offeror participation. Although qualification for attendance at the meetings is often based on total production of all securities, various offerors contribute to the meetings through cash payments, provision of training materials, payment for industry and motivational speakers, payment for meals and some entertainment and in other ways.

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[5] *See,* Securities Exchange Act Release No. 38993 (August 29, 1997).

It is difficult to rationalize how elimination of these meetings would be in the public interest. It would appear that the public interest is, in fact, better served through these meetings because of the educational value to the representatives.

Participation by Members in Non-Member Incentive Programs

There is no apparent reason to prohibit broker-dealers from participating in non-member incentive programs, such as those offered by banks. The NASD rules do not apply to non-members who are free to hold incentive programs. The NASD has offered no reason why prohibiting broker-dealers from providing speakers, education materials, advertising materials, or other such items is in the public interest. In fact, broker-dealer participation in these programs furthers the educational opportunities afforded to representatives located at banks for the benefit of the public.

TRAINING AND EDUCATIONAL MEETINGS

Rule Clarification

The proposed rule or accompanying interpretative material should make clear that non-incentive based meetings held by a member for its own associated persons are not subject to the requirements of proposed Rule 2311(b)(3).

Location

Permissible locations for training and educational meetings have been the subject of much confusion in the industry and should be clarified at this time. The NASD has publicly stated on a number of occasions that training and educational meetings should not be held in “exotic” locations. Any limitation on the location of a training and educational meeting, however, is difficult to rationalize, as the focus should be on the substance of the meeting and not the location. This is particularly true since entertainment has not historically been permitted at these meetings.

Even if limitations on location of training and educational meetings to avoid “exotic” locations are desirable, limitation of the meetings to United States locations does not make sense. It is difficult to understand why Hawaii or New York may be permissible but Toronto not. Moreover, it is difficult to understand why members and offerors who have parent companies with foreign headquarters should be prohibited from holding training and educational meetings at these locations.

Similarly, limiting the location of “regional” meetings to persons who “work within that region” is without rationale. At what point does a “region” have to be designated and by whom? Is there any logical reason why an east coast offeror could not hold a meeting for nationwide attendees in Chicago, Dallas, or some other central location for cost and convenience reasons?

We urge the NASD to provide substantially more clarity on permissible locations if they are to be restricted at all. The additional language in the current rules, as well as the proposed rules, adds no more clarity than the use of the phrase “appropriate to the purpose of the meetings,” which currently exists and has been retained in the Proposal.

Entertainment

The current rules and the proposed rule prohibit “entertainment” at training and educational meetings. We respectfully request that the NASD provide greater clarity to this provision. Certainly, entertainment that is incidental to the meeting such as music at dinners should not be prohibited.

CONCLUSION

In addition to the comments made above, we note that many of the current difficulties with enforcing cash and non-cash compensation arrangements stem from the fact that the NASD has put into effect rules that apply to broker-dealers but not the manufacturers and other industry participants. When the rules were clearly designed to assist broker-dealers in meeting their supervisory requirements, application of the rules to broker-dealers could be rationalized. However, those rules have now expanded beyond their original intent. The rules place limitations on broker-dealer incentive programs but not on incentive programs of issuers, such as “commission specials.” We believe that it is time for the NASD to work with the SEC to rectify this imbalance and urge the NASD to do so before implementation of additional rules.

The need for both the NASD and the SEC to work together to create rules that make sense for the industry as a whole is further shown by the anti-competitive effects the NASD rules have on broker-dealers. Investment advisers and banks, for instance, are not subject to the same prohibitions as are proposed here.

Respectfully submitted

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CEO