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August 5, 2005

Barbara Z. Sweeney
NASD
Senior Vice President and Corporate Secretary
1735 K Street, NW
Washington DC 20006-1500

Re: NASD Notice to Members 05-40 -- Request for Comment: Sales Contests and Non-Cash Compensation

Dear Ms. Sweeney:

The Pace Investor Rights Project (PIRP) at Pace University School of Law appreciates the opportunity to comment on NASD's proposed Rule 2311 to prohibit all product-specific sales contests and to apply non-cash compensation rules to sales of all securities, as outlined in NASD Notice to Members 05-40 ("Notice"). PIRP's mission is to advocate on behalf of investor justice, particularly with respect to the rights of small investors.

Broker-dealers owe their customers a duty to provide objective advice tailored to meet the customers' needs, yet conflicts of interest abound between brokerage firms and individual investors that may affect the suitability of the advice registered representatives provide to their customers. The conflicts of interest created by industry compensation practices were highlighted in the 1995 Tully Report, which reported that "the perception is strong that compensation practices create conditions that foster [investor] abuse."[1] Mary L. Schapiro, NASD Vice Chairman, recently stated that sales contests that favor the sale of some products over others "created conflicts of interests that could undermine the broker's obligation to recommend suitable investments based on the needs of the customer."[2] PIRP hopes that proposed Rule 2311 will be the first of many regulatory steps toward better aligning the interests of investors and brokerage firms. We observe that previous reform proposals were not implemented after public comment[3] and hope that proposed Rule 2311 does not suffer the same fate.

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[1] *See* Report of the Committee on Compensation Practices (the "Tully Report") at 4 (Apr. 10, 1995).
[2] *See* NASD Press Release, NASD Fines Hornor, Townsend & Kent, Inc. $325,000 for Improper Sales Contests, Email and Supervision Violations (July 6, 2005).
[3] *See* Salesperson Compensation Practices, NASD Notice to Members 99-81 (Sept. 1999).

The proposed rule recognizes the conflicts of interest inherent in non-cash compensation and product-specific sales contest arrangements and takes an important step towards fixing this problem. We agree with NASD's proposal to consolidate the existing rules relating to specific products into one all-encompassing rule in the hope that this will increase overall broker-dealers' adherence to their suitability objections. We also agree that product-specific sales contests create incentives for associated persons to engage in sales conduct unrelated to the best interests of the customer. Firms should never award associated persons honorary titles such as Gold Club Producer, President's Club, etc. (particularly with their attendant perks and increased payout) because of the sale of specific securities or types of securities. Instead, associated persons should be rewarded for successful sales practices that are based on objective and suitable recommendations for their customers. Accordingly, we support the proposed rule as an important step in further enhancing the interests of individual investors.

We note that the Notice specifically excludes its applicability to "different sales load structures or ongoing differential cash payouts among various products," which is the subject of SEC rulemaking.[4] We hope that NASD and SEC will coordinate its efforts to improve disclosure in this area, both through rulemaking and enforcement actions.[5] Unless specifically asked by a client or prospective client, many registered representatives do not mention that they receive higher gross commissions or payout percentages for proprietary "in house" products.

In addition, the proposal makes no reference to products with the potential for proprietary cross-selling, such as credit cards, mortgages, financial plans, and insurance products. In many instances the associated person is not licensed to sell these goods, but receives non-cash bonuses for recommending these products to their clients. These non-cash incentives, point systems and bonus plans (in essence, non-cash "finder's fees") also create a conflict of interest between clients and their representatives' duties of good faith and fair dealing. NASD should review these non-security-related practices of member firms to the greatest extent of its permissible authority.

Conclusion

We are pleased to see NASD take this positive step toward renewing investor confidence in registered representatives and the brokerage industry as a whole. Though there is more work that needs to be done, we believe prohibiting all product-specific sales contests and applying non-cash compensation rules to sales of all securities will assist in further protecting investors' interests.

Respectfully submitted,

Jill I. Gross	Barbara Black	Daniel Timins
Director of Advocacy	Director of Research	Student Intern

[4] *See* Point of Sale Disclosure Requirements and Confirmation Requirements for Transactions in Mutual Funds, College Savings Plans, and Certain Other Securities, and Amendments to the Registration Form for Mutual Funds, Rel. 33-8544 (Feb. 28, 2005).

[5] *See*, *e.g*., In re Morgan Stanley DW, Inc., SEC Rel. 33-8339 (Nov. 17, 2003) (censuring broker-dealer for failing to disclose different sales load structures for Investment Company partners programs).