

Financial Services and Products ADVISORY

July 8, 2009

FINRA Proposes Consolidated Rule Governing the Sale of Investment Company Securities

On June 17, 2009, as part of the ongoing process to develop a consolidated FINRA rulebook, FINRA proposed new FINRA Rule 2341 (the “Proposed Rule”) regarding the distribution and sale of investment company securities.¹ The Proposed Rule is largely based on current NASD Rule 2830 (“Rule 2830”), but includes four key changes. It would

- require firms to make new disclosures to investors regarding the receipt of cash compensation;
- make minor changes to the record keeping requirements for non-cash compensation;
- eliminate a condition regarding discounted sales of investment company securities to dealers; and
- codify past FINRA staff interpretations regarding purchases and sales of exchange-traded funds (ETFs).

These changes are discussed in greater detail below.

Comments on the Proposed Rule must be received by FINRA on or before **August 3, 2009**.

Proposed Changes to the Cash Compensation Provisions

Rule 2830 governs the payment and acceptance of cash and non-cash compensation in connection with the sale of investment company securities, and generally requires the disclosure of such payments. The Proposed Rule modifies the existing disclosures for cash compensation as follows:

- It requires that standard “sales charges and service fees,” rather than all cash compensation, be described in the prospectus.
- It eliminates the term “special cash compensation” and instead requires prospectus disclosure if a member firm receives greater (or special) sales charges or service fees than are ordinarily paid in connection with sales of fund shares, while other types of cash compensation, such as revenue-sharing payments, would not require prospectus disclosure.

¹ FINRA Notice to Members 09-34 (July 2009).

- It requires a member firm that receives cash payments in addition to the standard sales charges and service fees paid in connection with the sale of fund shares to
 - disclose that information about a fund’s fees and expenses may be found in the fund’s prospectus;
 - disclose, if applicable, (i) that the firm receives cash payments in addition to the standard sales charges and service fees disclosed in the prospectus, (ii) the nature of such payments received in the last 12 months and (iii) a list of fund offerors making such payments listed in descending order of payments received; and
 - provide a reference to a Web page or toll-free number containing updated information, which must be updated at least every six months (or, if the firm elects not to maintain a Web page or toll-free number, disclose updated information to customers every six months).
- It adds supplementary material that clarifies provisions regarding the disclosure of cash compensation and supersedes all prior guidance with respect to these provisions. The supplementary material provides that
 - “cash compensation” includes revenue sharing paid in connection with the sale and distribution of investment company securities (and therefore member firms would be required to disclose revenue sharing arrangements pursuant to the Proposed Rule);
 - “cash compensation” also includes these payments, whether they are based upon the amount of investment company assets that a member’s customers hold, the amount of investment company securities that the member has sold or any other amount, if the payment is related to the sale and distribution of the investment company’s securities;
 - a “special sales charge” or “service fee arrangement” includes any arrangement under which a member firm receives greater sales charges or service fees than other member firms selling the same investment company securities (e.g., if a member receives the full gross sales charge imposed on the sale of investment company securities while other members selling the same securities receive only a portion of the gross sales charge, or if a member receives a cash payout in addition to the regular commission paid on the sale of investment company securities and other members do not receive this additional cash payout); and
 - the “special sales charge” or “service fee arrangement” disclosure requirement applies even if a fund’s offeror would have made the same arrangement available to other members had they requested it.

As with Rule 2830, the Proposed Rule requires the names of the firms that have entered into arrangements to receive special sales charges or service fees (and the details of these arrangements) to be disclosed in the prospectus or SAI.

Proposed Changes to the Non-Cash Compensation Provisions

Subject to certain exceptions, Rule 2830 generally prohibits member firms and their associated persons from accepting or paying non-cash compensation. Rule 2830 also generally requires member firms to keep records of all compensation received by the member firm or its associated persons to include the nature of and—“if known”—the value of any non-cash compensation received.

The Proposed Rule modifies this requirement by deleting the phrase “if known” regarding the value of non-cash compensation. Firms would be permitted to estimate in good faith the actual value of non-cash compensation received for which a receipt (or similar documentation) assigning a value is not available.

Proposed Changes Regarding Conditions for Discounts to Dealers

Rule 2830 currently prohibits investment company underwriters from selling the fund’s securities to a retail broker-dealer at a price other than the public offering price unless, among other conditions, the sale is in conformance with NASD Rule 2420 (Dealing with Non-Members). Due to the fact that virtually all broker-dealers currently doing business with the public are FINRA members, the Proposed Rule eliminates the requirement that such sales be in conformance with Rule 2420.

Proposed Changes Regarding Sales of ETFs

The Proposed Rule includes a provision to codify earlier FINRA staff interpretive letters that permit the trading of ETF shares at prices other than the current net asset value consistent with applicable SEC rules or exemptive orders.

If you would like to receive future *Financial Services and Products Advisories* electronically, please forward your contact information including e-mail address to financialservices@alston.com. Be sure to put "**subscribe**" in the subject line.

Please visit our blog at <http://www.alston.com/financialmarketscrisisblog>.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any one of the following members of the Investment Management Group.

Investment Management Group

Joshua Andersen
josh.andersen@alston.com
202.756.3355

Ashley E. Hufft
ashley.hufft@alston.com
212.210.9437

Timothy P. Selby
tim.selby@alston.com
212.210.9494

Paul M. Architzel
paul.architzel@alston.com
202.756.3492

Lawanna Kimbro
lawanna.kimbrow@alston.com
212.210.9486

Margaret A. Sheehan
margaret.sheehan@alston.com
202.756.3305

David J. Baum
david.baum@alston.com
202.756.3346

Jennifer D. Lawrence
jennifer.lawrence@alston.com
704.444.1337

Matthew C. Sippel
matthew.sippel@alston.com
212.210.9581

Willa Cohen Bruckner
willa.bruckner@alston.com
212.210.9596

Matthew W. Mamak
matthew.mamak@alston.com
212.210.1256

James H. Sullivan, Jr.
james.sullivan@alston.com
212.210.9522

Mark F. Costley
mark.costley@alston.com
202.756.5593

Kristin P. Manzano
kris.manzano@alston.com
704.444.1332

Maureen Whalen
maureen.whelen@alston.com
704.444.1294

Paul D. Hourigan
paul.hourigan@alston.com
202.756.3155

Andrea L. Parisi
andrea.paris@alston.com
212.210.9580

Sarah Whitlock
sarah.whitlock@alston.com
212.210.9574

ATLANTA

One Atlantic Center
1201 West Peachtree Street
Atlanta, GA 30309-3424
404.881.7000

CHARLOTTE

Bank of America Plaza
Suite 4000
101 South Tryon Street
Charlotte, NC 28280-4000
704.444.1000

DALLAS

Chase Tower
Suite 3601
2200 Ross Avenue
Dallas, TX 75201
214.922.3400

LOS ANGELES

333 South Hope Street
16th Floor
Los Angeles, CA 90071-3004
213.576.1000

NEW YORK

90 Park Avenue
New York, NY 10016-1387
212.210.9400

RESEARCH TRIANGLE

Suite 600
3201 Beechleaf Court
Raleigh, NC 27604-1062
919.862.2200

SILICON VALLEY

Two Palo Alto Square
Suite 400
3000 El Camino Real
Palo Alto, CA 94306-2112
650.838.2000

VENTURA COUNTY

Suite 215
2801 Townsgate Road
Westlake Village, CA 91361
805.497.9474

WASHINGTON, D.C.

The Atlantic Building
950 F Street, NW
Washington, DC 20004-1404
202.756.3300

www.alston.com

© Alston & Bird LLP 2009