

(D) Subparagraphs (A) and (B), and, only in situations where the member is not affiliated with the direct participation program, subparagraph (C) shall not apply to:

(i) a secondary public offering of or a secondary market transaction in a unit, depositary receipt, or other interest in a direct participation program that is listed on a national securities exchange; or

(ii) an initial public offering of a unit, depositary receipt or other interest in a direct participation program for which an application for listing on a national securities exchange has been approved by such exchange and the applicant makes a good faith representation that it believes such listing on an exchange will occur within a reasonable period of time following the formation of the program.

(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) In determining the adequacy of disclosed facts pursuant to subparagraph (A) hereof, a member or person associated with a member shall obtain information on material facts relating to a minimum to the following, if relevant in view of the nature of the program:

- (i) items of compensation;
- (ii) physical properties;
- (iii) tax aspects;
- (iv) financial stability and experience of the sponsor;
- (v) the program's conflict and risk factors; and
- (vi) appraisals and other pertinent reports.

(C) For purposes of subparagraphs (A) or (B) hereof, a member or person associated with a member may rely upon the results of an inquiry conducted by another member or members, provided that:

- (i) the member or person associated with a member has reasonable grounds to believe that such inquiry was conducted with due care;
- (ii) the results of the inquiry were provided to the member or person associated with a member with the consent of the member or members conducting or directing the inquiry; and
- (iii) no member that participated in the inquiry is a sponsor of the program or an affiliate of such sponsor.

(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, this subparagraph (D) 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 meets the criteria in paragraph (b)(2)(D)(i) or (ii).

(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 paragraph (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;

(ii) the total amount of all items of compensation from whatever source, including compensation paid from offering proceeds and in the form of "trail commissions," payable to underwriters, broker-dealers, or affiliates thereof exceeds an amount that equals ten percent of the gross proceeds of the offering (excluding securities purchased through the reinvestment of dividends);

(iii) any compensation in connection with an offering is to be paid to underwriters, broker-dealers, or affiliates thereof out of the proceeds of the offering prior to the release of such proceeds from escrow, provided, however, that any such payment from sources other than proceeds of the offering shall be made only on the basis of bona fide transactions;

(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;

(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 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) 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 became effective prior to August 6, 2008; 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 paragraph (b)(4)(B)(i) above include the following:

(i) issuer expenses that are reimbursed or paid for with offering proceeds, including overhead expenses, which issuer expenses 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 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 FINRA fees;

(ii) underwriting compensation, which includes but is not limited to items of compensation listed in Rule 5110(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, except to the extent that such compensation has been included in a. above;
- c. to any registered representative who is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities, except:
 1. to the extent that such compensation has been included in a. above;
 2. for a registered representative whose functions in connection with the offering are solely and exclusively clerical or ministerial; and
 3. for a registered representative whose sales activities are *de minimis* and incidental to his or her clerical or ministerial job functions; 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 paragraphs (b)(4)(C)(ii)b. and c. above, for every program or REIT filed with the Corporate Financing Department (the "Department") for review, the Department shall, based upon the information provided, make a determination as to whether 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:

(i) a dual employee of a member and the sponsor, issuer or other affiliate with respect to a program or REIT with ten or fewer registered representatives engaged in wholesaling, in which instance the Department may make such determination with respect to the ten or fewer registered representatives engaged in wholesaling; or

(ii) a dual employee of a member and the sponsor, issuer or other affiliate who is one of the top ten highest paid executives based on non-transaction-based compensation in any program or REIT.

(E) All items of compensation paid by the program or REIT directly or indirectly from whatever source to underwriters, broker-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. is subject to potential liability as a general partner to the same extent as any other general partner;
- b. is not indemnified against potential liability as a general partner to any greater or different extent than any other general partner for its actions or those of any other general partner;
- 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) For purposes of determining the factors to be utilized in computing compensation derived from securities received in connection with a public offering, the guidelines set forth in Rule 5110 shall govern to the extent applicable.

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

- (i) all compensation is paid directly to the member in cash and the distribution, if any, of all compensation to the member's associated persons is controlled solely by the member;
- (ii) the value of all compensation to be paid in connection with an offering is included as compensation to be received in connection with the offering for purposes of subparagraph (B);
- (iii) arrangements relating to the proposed payment of all compensation are disclosed in the prospectus or similar offering document;
- (iv) the value of all compensation paid in connection with an offering is reflected on the books and records of the recipient member as compensation received in connection with the offering; and
- (v) no compensation paid in connection with an offering is directly or indirectly related to any non-cash compensation or sales incentive items provided by the member to its associated persons.

(5) Valuation for Customer Account Statements

A member shall not participate in a public offering of the securities of a direct participation program (DPP) that is not subject to the requirements of the Investment Company Act of 1940 or of a REIT unless the issuer of the DPP or REIT has agreed to disclose:

(A) a per share estimated value of the DPP or REIT security, developed in a manner reasonably designed to ensure it is reliable, in the DPP or REIT periodic reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act;

(B) an explanation of the method by which the per share estimated value was developed;

(C) the date of the valuation; and

(D) in a periodic or current report filed pursuant to Section 13(a) or 15(d) of the Exchange Act within 150 days following the second anniversary of breaking escrow and in each annual report thereafter, a per share estimated value:

(i) based on valuations of the assets and liabilities of the DPP or REIT performed at least annually, by, or with the material assistance or confirmation of, a third-party valuation expert or service;

(ii) derived from a methodology that conforms to standard industry practice; and

(iii) accompanied by a written opinion or report by the issuer, delivered at least annually, that explains the scope of the review, the methodology used to develop the valuation or valuations, and the basis for the value or values reported.

(6) Participation in Rollups

(A) No member or person associated with a member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction, irrespective of the form of the resulting entity (i.e., a partnership, real estate investment trust or corporation), unless any compensation received by the member:

(i) is payable and equal in amount regardless of whether the limited partner votes affirmatively or negatively in the proposed limited partnership rollup transaction;

(ii) in the aggregate, does not exceed 2% of the exchange value of the newly created securities; and

(iii) is paid regardless of whether the limited partners reject the proposed limited partnership rollup transaction.

(B) No member or person associated with a member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction unless the general partner(s) or sponsor(s) proposing the limited partnership rollup transaction agrees to pay all solicitation expenses related to the limited partnership rollup transaction, including all preparatory work related thereto, in the event the limited partnership rollup transaction is rejected.

(C) No member or person associated with a member shall participate in any capacity in a limited partnership rollup transaction if the transaction is unfair or unreasonable.

(i) A limited partnership rollup transaction will be presumed not to be unfair or unreasonable if the limited partnership rollup transaction provides for the right of dissenting limited partners:

a. to receive compensation for their limited partnership units based on an appraisal of the limited partnership assets performed by an independent appraiser unaffiliated with the sponsor or general partner of the program that values the assets as if sold in an orderly manner in a reasonable period of time, plus or minus other balance sheet items, and less the cost of sale or refinancing and in a manner consistent with the appropriate industry practice. Compensation to dissenting limited partners of limited partnership rollup transactions may be cash, secured debt instruments, unsecured debt instruments, or freely tradeable securities; provided, however, that:

1. limited partnership rollup transactions which utilize debt instruments as compensation must provide for a trustee and an indenture to protect the rights of the debt holders and provide a rate of interest equal to at least 120% of the applicable federal rate as determined in accordance with Section 1274 of the Internal Revenue Code of 1986;

2. limited partnership rollup transactions which utilize unsecured debt instruments as compensation, in addition to the requirements of subparagraph 1., must limit total leverage to 70% of the appraised value of the assets;

3. all debt securities must have a term no greater than 8 years and provide for prepayment with 80% of the net proceeds of any sale or refinancing of the assets previously owned by the partnership entities subject to the limited partnership rollup transaction or any part thereof; and

4. freely tradeable securities used as compensation to dissenting limited partners must be previously listed on a national securities exchange prior to the limited partnership rollup transaction, and the number of securities to be received in return for limited partnership interests must be determined in relation to the average last sale price of the freely tradeable securities in the 20-day period following the date of the meeting at which the vote on the limited partnership rollup transaction occurs. If the issuer of the freely tradeable securities is affiliated with the sponsor or general partner, newly issued securities to be used as compensation to dissenting limited partners shall not represent more than 20 percent of the issued and outstanding shares of that class of securities after giving effect to the issuance. For purposes of the preceding sentence, a sponsor or general partner is "affiliated" with the issuer of the freely tradeable securities if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the limited partnership rollup transaction or the purchase of the general partner's interest; provided, however, that nothing herein shall restrict the ability of a sponsor or general partner to receive any payment for its equity interests and compensation as otherwise provided by this subparagraph.

b. to receive or retain a security with substantially the same terms and conditions as the security originally held. Securities received or retained will be considered to have the same terms and conditions as the security originally held if:

1. there is no material adverse change to dissenting limited partners' rights with respect to the business plan or the investment, distribution and liquidation policies of the limited partnership; and

2. the dissenting limited partners receive substantially the same rights, preferences and priorities as they had pursuant to the security originally held; or

c. to receive other comparable rights including, but not limited to:

1. approval of the limited partnership rollup transaction by 75% of the outstanding units of each of the individual participating limited partnerships and the exclusion of any individual limited partnership from the limited partnership rollup transaction which fails to reach the 75% threshold. The third-party appointed to tabulate votes and dissents pursuant to subparagraph (C)(ii)b.4. hereof shall submit the results of such tabulation to FINRA;

2. review of the limited partnership rollup transaction by an independent committee of persons not affiliated with the general partner(s) or sponsor. Whenever utilized, the independent committee:

A. shall be approved by a majority of the outstanding securities of each of the participating partnerships;

B. shall have access to the books and records of the partnerships;

C. shall prepare a report to the limited partners subject to the limited partnership rollup transaction that presents its findings and recommendations, including any minority views;

D. shall have the authority to negotiate the proposed transaction with the general partner or sponsor on behalf of the limited partners, but not the authority to approve the transaction on behalf of the limited partners;

E. shall not deliberate for a period longer than 60 days, although extensions will be permitted if unanimously agreed upon by the members of the independent committee or if approved by FINRA;

F. may be compensated and reimbursed by the limited partnerships subject to the limited partnership rollup transaction and shall have the ability to retain independent counsel and financial advisors to represent all limited partners at the limited partnerships' expense provided the fees are reasonable; and

G. shall be entitled to indemnification to the maximum extent permitted by law from the limited partnerships subject to the limited partnership rollup transaction from claims, causes of action or lawsuits related to any action or decision made in furtherance of their responsibilities; provided, however, that general partners or sponsors may also agree to indemnify the independent committee; or

3. any other comparable rights for dissenting limited partners proposed by general partners or sponsors, provided, however, that the general partner(s) or sponsor demonstrates to the satisfaction of FINRA or, if FINRA determines appropriate, to the satisfaction of an independent committee, that the rights proposed are comparable.

(ii) Regardless of whether a limited partnership rollup transaction is in compliance with subparagraph (C)(i), a limited partnership rollup transaction will be presumed to be unfair and unreasonable:

a. if the general partner(s):

1. converts an equity interest in any limited partnership(s) subject to a limited partnership rollup transaction for which consideration was not paid and which was not otherwise provided for in the limited partnership agreement and disclosed to limited partners, into a voting interest in the new entity (provided, however, an interest originally obtained in order to comply with the provisions of Internal Revenue Service Revenue Proclamation 89-12 may be converted);

2. fails to follow the valuation provisions, if any, in the limited partnership agreements of the subject limited partnerships when valuing their limited partnership interests; or

3. utilizes a future value of their equity interest in the limited partnership rather than the current value of their equity interest, as determined by an appraisal conducted in a manner consistent with subparagraph (C)(i)a., when determining their interest in the new entity;

b. as to voting rights, if:

1. the voting rights in the entity resulting from a limited partnership rollup transaction do not generally follow the original voting rights of the limited partnerships participating in the limited partnership rollup transaction; provided, however, that changes to voting rights may be effected if FINRA determines that such changes are not unfair or if the changes are approved by an independent committee;

2. a majority of the interests in an entity resulting from a limited partnership rollup transaction may not, without concurrence by the sponsor, general partner(s), board of directors, trustee, or similar governing entity, depending on the form of entity and to the extent not inconsistent with applicable state law, vote to:

A. amend the limited partnership agreement, articles of incorporation or by-laws, or indenture;

B. dissolve the entity;

C. remove the general partner, board of directors, trustee or similar governing entity, and elect a new general partner, board of directors, trustee or similar governing entity; or

D. approve or disapprove the sale of substantially all of the assets of the entity;

3. the general partner(s) or sponsor(s) proposing a limited partnership rollup transaction do not provide each limited partner with a document which instructs the limited partner on the proper procedure for voting against or dissenting from the transaction; or

4. the general partner(s) or sponsor(s) does not utilize an independent third party to receive and tabulate all votes and dissents in connection with the limited partnership rollup transaction, and require that the third party make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs;

c. as to transaction costs, if:

1. transaction costs of a rejected limited partnership rollup transaction are not apportioned between general and limited partners of the subject limited partnerships according to the final vote on the proposed transaction as follows:

A. the general partner(s) or sponsor(s) bear all transaction costs in proportion to the total number of abstentions and votes to reject the limited partnership rollup transaction; and

B. limited partners bear transaction costs in proportion to the number of votes to approve the limited partnership rollup transaction; or

2. individual limited partnerships that do not approve a limited partnership rollup transaction are required to pay any of the transaction costs, and the general partner or sponsor is not required to pay the transaction costs on behalf of the non-approving limited partnerships, in a limited partnership rollup transaction in which one or more limited partnerships determines not to approve the transaction, but where the transaction is consummated with respect to one or more approving limited partnerships; or

d. as to fees of general partners, if:

1. general partners are not prevented from receiving both unearned management fees discounted to a present value (if such fees were not previously provided for in the limited partnership agreement and disclosed to limited partners) and new asset-based fees;

2. property management fees and other general partner fees are inappropriate, unreasonable and more than, or not competitive with, what would be paid to third parties for performing similar services; or

3. changes in fees which are substantial and adverse to limited partners are not approved by an independent committee according to the facts and circumstances of each transaction.

(c) Non-Cash Compensation

(1) Definitions

The terms "compensation," "non-cash compensation" and "offeror" for the purposes of this paragraph (c) shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of direct participation securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, sponsor, an adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities.

(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) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors¹ and are not conditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(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) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (c)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean a United States 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 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) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the offeror is not conditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (c)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (c)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs (c)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with paragraph (c)(2)(C) through (E).

(d) Exemptions

Pursuant to the Rule 9600 Series, FINRA may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

¹ The current annual amount fixed by the Board of Governors is \$100.

Amended by SR-FINRA-2019-009 eff. May 8, 2019.
 Amended by SR-FINRA-2014-006 eff. April 11, 2016.
 Amended by SR-FINRA-2009-046 eff. Aug. 17, 2009.
 Amended by SR-FINRA-2009-016 eff. Aug. 17, 2009.
 Amended by SR-NASD-2005-114 eff. Aug. 6, 2008.
 Amended by SR-NASD-2005-087 eff. Aug. 1, 2006.
 Amended by SR-NASD-2003-68 eff. April 7, 2003.
 Amended by SR-NASD-00-13 eff. April 16, 2001.
 Amended by SR-NASD-97-28 eff. Aug. 7, 1997.
 Amended by SR-NASD-95-21 eff. July 11, 1995.
 Amended by SR-NASD-95-19 eff. July 3, 1995.
 Amended by SR-NASD-93-03 eff. Nov. 1, 1994.
 Amended to incorporate Appendix F by SR-NASD-93-48 eff. Mar. 8, 1994.
 Amended SR-NASD-81-19 eff. Sept. 16, 1982; Jan. 17, 1984; SR-NASD-84-2 eff. July 3, 1984; SR-NASD-85-26 eff. Nov. 5, 1985; SR-NASD-86-21 eff. Sept. 15, 1986; SR-NASD-86-22 eff. Jan. 1, 1989; SR-NASD-84-10 eff. Feb. 1, 1989; SR-NASD-91-24 eff. Aug. 19, 1991; SR-NASD-93-29 eff. June 23, 1993.
 Adopted by SR-NASD-77-8 eff. July 14, 1980.

Selected Notices: 73-50, 77-03, 78-12, 81-34, 82-14, 82-50, 82-51, 82-52, 83-13, 84-28, 84-64, 85-17, 85-29, 86-66, 86-81, 88-88, 89-16, 91-56, 91-78, 93-15, 93-44, 94-24, 94-70, 95-63, 95-64, 08-35, 09-33, 15-02.

VERSIONS

May 08, 2019 - Jun 29, 2020



2320. Variable Contracts of an Insurance Company

[The Rule](#)[Notices](#)

This version is valid from Jul 09, 2016 through Jun 29, 2020.

Amendments have been announced but are not yet effective. To view other versions open the versions tab on the right.

(a) Application

This Rule shall apply exclusively (and in lieu of Rule 2341) to the activities of members in connection with variable contracts, to the extent such activities are subject to regulation under the federal securities laws.

(b) Definitions

(1) The term "purchase payment" as used throughout this Rule shall mean the consideration paid at the time of each purchase or installment for or under the variable contract.

(2) The term "variable contracts" shall mean contracts providing for benefits or values which may vary according to the investment experience of any separate or segregated account or accounts maintained by an insurance company.

(3) The terms "affiliated member," "compensation," "cash compensation," "non-cash compensation" and "offeror" as used in paragraph (g) of this Rule shall have the following meanings:

(A) "Affiliated Member" shall mean a member which, directly or indirectly, controls, is controlled by, or is under common control with a non-member company.

(B) "Compensation" shall mean cash compensation and non-cash compensation.

(C) "Cash compensation" shall mean any discount, concession, fee, service fee, commission, asset based sales charge, loan, override, or cash employee benefit received in connection with the sale and distribution of variable contracts.

(D) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of variable contracts that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(E) "Offeror" shall mean an insurance company, a separate account of an insurance company, an investment company that funds a separate account, any adviser to a separate account of an insurance company or an investment company that funds a separate account, a fund administrator, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act) of such entities.

(c) Receipt of Payment

No member shall participate in the offering or in the sale of a variable contract on any basis other than at a value to be determined following receipt of payment therefor in accordance with the provisions of the contract, and, if applicable, the prospectus, the Investment Company Act and applicable rules thereunder. Payments need not be considered as received until the contract application has been accepted by the insurance company, except that by mutual agreement it may be considered to have been received for the risk of the purchaser when actually received.

(d) Transmittal

Every member who receives applications and/or purchase payments for variable contracts shall transmit promptly to the issuer all such applications and at least that portion of the purchase payment required to be credited to the contract.

(e) Selling Agreements

No member who is a principal underwriter as defined in the Investment Company Act may sell variable contracts through another broker-dealer unless (1) such broker-dealer is a member, and (2) there is a sales agreement in effect between the parties. Such sales agreement must provide that the sales commission be returned to the issuing insurance company if the variable contract is tendered for redemption within seven business days after acceptance of the contract application.

(f) Redemption

No member shall participate in the offering or in the sale of a variable contract unless the insurance company, upon receipt of a request in proper form for partial or total redemption in accordance with the provisions of the contract undertakes to make prompt payment of the amounts requested and payable under the contract in accordance with the terms thereof, and, if applicable, the prospectus, the Investment Company Act and applicable rules thereunder.

(g) Member Compensation

In connection with the sale and distribution of variable contracts:

(1) Except as described below, no associated person of a member shall accept any compensation from anyone other than the member with which the person is associated. This requirement will not prohibit arrangements where a non-member company pays compensation directly to associated persons of the member, provided that:

(A) the arrangement is agreed to by the member;

(B) the member relies on an appropriate rule, regulation, interpretive release, interpretive letter, or "no-action" letter issued by the SEC that applies to the specific fact situation of the arrangement;

(C) the receipt by associated persons of such compensation is treated as compensation received by the member for purposes of the FINRA rules; and

(D) the record keeping requirement in paragraph (g)(3) is satisfied.

(2) No member or person associated with a member shall accept any compensation from an offeror which is in the form of securities of any kind.

(3) Except for items as described in paragraphs (g)(4)(A) and (B), a member shall maintain records of all compensation received by the member or its associated persons from offerors. The records shall include the names of the offerors, the names of the associated persons, the amount of cash, and the nature and value of non-cash compensation received.

(4) 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. Notwithstanding the provisions of paragraph (g)(1), the following non-cash compensation arrangements are permitted:

(A) Gifts that do not exceed an annual amount per person fixed periodically by FINRA¹ and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(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) the record keeping requirement in paragraph (g)(3) is satisfied;

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (g)(4)(D);

(iii) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iv) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (g)(4)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that:

(i) the member's or non-member's non-cash compensation arrangement, if it includes variable contract securities, is based on the total production of associated persons with respect to all variable contract securities distributed by the member;

(ii) the non-cash compensation arrangement requires that the credit received for each variable contract security is equally weighted;

(iii) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(iv) the record keeping requirement in paragraph (g)(3) is satisfied.

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (g)(4)(D).

¹ The current annual amount fixed by FINRA is \$100.

Amended by SR-FINRA-2016-026 eff. July 9, 2016.
 Amended by SR-FINRA-2009-023 eff. Oct. 19, 2009.
 Amended by SR-NASD-98-14 eff. April 1, 2000.
 Amended by SR-NASD-97-35 eff. Jan. 1, 1999.
 Amended eff. May 1, 1976.
 Added eff. Feb. 8, 1971.

Selected Notices: 75-68, 88-17, 91-25, 91-68, 94-67, 95-56, 96-52, 96-86, 97-27, 97-48, 97-50, 98-75, 99-35, 99-55, 99-103, 00-44, 01-63, 09-50.

VERSIONS

Jul 09, 2016 - Jun 29, 2020



2330. Members' Responsibilities Regarding Deferred Variable Annuities

[The Rule](#)[Notices](#)

(a) General Considerations

(1) Application

This Rule applies to recommended purchases and exchanges of deferred variable annuities and recommended initial subaccount allocations. This Rule does not apply to reallocations among subaccounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. This Rule also does not apply to deferred variable annuity transactions made in connection with any tax-qualified, employer-sponsored retirement or benefit plan that either is defined as a "qualified plan" under Section 3(a)(12)(C) of the Exchange Act or meets the requirements of Internal Revenue Code Sections 403(b), 457(b), or 457(f), unless, in the case of any such plan, a member or person associated with a member makes recommendations to an individual plan participant regarding a deferred variable annuity, in which case the Rule would apply as to the individual plan participant to whom the member or person associated with the member makes such recommendations.

(2) Creation, Storage, and Transmission of Documents

For purposes of this Rule, documents may be created, stored, and transmitted in electronic or paper form, and signatures may be evidenced in electronic or other written form.

(3) Definitions

For purposes of this Rule, the term "registered principal" shall mean a person registered as a General Securities Sales Supervisor (Series 9/10), a General Securities Principal (Series 24) or an Investment Company Products/Variable Contracts Principal (Series 26), as applicable.

(b) Recommendation Requirements

(1) No member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has a reasonable basis to believe

(A) that the transaction is suitable in accordance with Rule 2111 and, in particular, that there is a reasonable basis to believe that

(i) the customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk;

(ii) the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and

(iii) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by paragraph (b)(2) of this Rule; and

(B) in the case of an exchange of a deferred variable annuity, the exchange also is consistent with the suitability determination required by paragraph (b)(1)(A) of this Rule, taking into consideration whether

(i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements);

(ii) the customer would benefit from product enhancements and improvements; and

(iii) the customer has had another deferred variable annuity exchange within the preceding 36 months.

The determinations required by this paragraph shall be documented and signed by the associated person recommending the transaction.

(2) Prior to recommending the purchase or exchange of a deferred variable annuity, a member or person associated with a member shall make reasonable efforts to obtain, at a minimum, information concerning the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.

(3) Promptly after receiving information necessary to prepare a complete and correct application package for a deferred variable annuity, a person associated with a member who recommends the deferred variable annuity shall transmit the complete and correct application package to an office of supervisory jurisdiction of the member.

(c) Principal Review and Approval

Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after an office of supervisory jurisdiction of the member receives a complete and correct application package, a registered principal shall review and determine whether he or she approves of the recommended purchase or exchange of the deferred variable annuity.

A registered principal shall approve the recommended transaction only if he or she has determined that there is a reasonable basis to believe that the transaction would be suitable based on the factors delineated in paragraph (b) of this Rule.

The determinations required by this paragraph shall be documented and signed by the registered principal who reviewed and then approved or rejected the transaction.

(d) Supervisory Procedures

In addition to the general supervisory and recordkeeping requirements of Rules 3110, 3120, 3130, 3150, and 4510 Series, a member must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in this Rule. The member also must (1) implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

(e) Training

Members shall develop and document specific training policies or programs reasonably designed to ensure that associated persons who effect and registered principals who review transactions in deferred variable annuities comply with the requirements of this Rule and that they understand the material features of deferred variable annuities, including those described in paragraph (b)(1)(A)(i) of this Rule.

••• Supplementary Material: -----

.01 Depositing of Funds by Members Prior to Principal Approval. Under Rule 2330, a member that is permitted to maintain customer funds under SEA Rules 15c3-1 and 15c3-3 may, prior to the member's principal approval of the deferred variable annuity, deposit and maintain customer funds for a deferred variable annuity in an account that meets the requirements of SEA Rule 15c3-3.

.02 Treatment of Lump-Sum Payment for Purchases of Different Products. If a customer provides a member that is permitted to hold customer funds with a lump sum or single check made payable to the member (as opposed to being made payable to the insurance company) and requests that a portion of the funds be applied to the purchase of a deferred variable annuity and the rest of the funds be applied to other types of products, Rule 2330 would not prohibit the member from promptly applying those portions designated for purchasing products other than a deferred variable annuity to such use. A member that is not permitted to hold customer funds can comply with such requests only through its clearing firm that will maintain customer funds for the intended deferred variable annuity purchase in an account that meets the requirements of SEA Rule 15c3-3. In such circumstances, the checks would need to be made payable to the clearing firm.

.03 Forwarding of Checks/Funds to Insurer Prior to Principal Approval. Rule 2330 does not prohibit a member from forwarding a check made payable to the insurance company or, if the member is fully subject to SEA Rule 15c3-3, transferring funds for the purchase of a deferred variable annuity to the insurance company prior to the member's principal approval of the deferred variable annuity, as long as the member fulfills the following requirements: (a) the member must disclose to the customer the proposed transfer or series of transfers of the funds and (b) the member must enter into a written agreement with the insurance company under which the insurance company agrees that, until such time as it is notified of the member's principal approval and is provided with the application or is notified of the member's principal rejection, it will (1) segregate the member's customers' funds in a bank in an account equivalent to the deposit of those funds by a member into a "Special Account for

the Exclusive Benefit of Customers" (set up as described in SEA Rules 15c3-3(k)(2)(i) and 15c3-3(f)) to ensure that the customers' funds will not be subject to any right, charge, security interest, lien, or claim of any kind in favor of the member, insurance company, or bank where the insurance company deposits such funds or any creditor thereof or person claiming through them and hold those funds either as cash or any instrument that a broker or dealer may deposit in its Special Reserve Account for the Exclusive Benefit of Customers, (2) not issue the variable annuity contract prior to the member's principal approval, and (3) promptly return the funds to each customer at the customer's request prior to the member's principal approval or upon the member's rejection of the application.

.04 Forwarding of Checks/Funds to IRA Custodian Prior to Principal Approval. A member is not prohibited from forwarding a check provided by the customer for the purpose of purchasing a deferred variable annuity and made payable to an IRA custodian for the benefit of the customer (or, if the member is fully subject to SEA Rule 15c3-3, funds) to the IRA custodian prior to the member's principal approval of the deferred variable annuity transaction, as long as the member enters into a written agreement with the IRA custodian under which the IRA custodian agrees (a) to forward the funds to the insurance company to complete the purchase of the deferred variable annuity contract only after it has been informed that the member's principal has approved the transaction and (b), if the principal rejects the transaction, to inform the customer, seek immediate instructions from the customer regarding alternative disposition of the funds (e.g., asking whether the customer wants to transfer the funds to another IRA custodian, purchase a different investment, or provide other instructions), and promptly implement the customer's instructions.

.05 Gathering of Information Regarding Customer Exchanges. Rule 2330 requires that the member or person associated with a member consider whether the customer has had another deferred variable annuity exchange within the preceding 36 months. Under this provision, a member or person associated with a member must determine whether the customer has had such an exchange at the member and must make reasonable efforts to ascertain whether the customer has had an exchange at any other broker-dealer within the preceding 36 months. An inquiry to the customer as to whether the customer has had an exchange at another broker-dealer within 36 months would constitute a "reasonable effort" in this context. Members shall document in writing both the nature of the inquiry and the response from the customer.

.06 Sharing of Office Space and/or Employees. Rule 2330 requires principal review and approval "[p]rior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing..." In circumstances where an insurance company and its affiliated broker-dealer share office space and/or employees who carry out both the principal review and the issuance process, FINRA will consider the application "transmitted" to the insurance company only when the broker-dealer's principal, acting as such, has approved the transaction, provided that the affiliated broker-dealer and the insurance company have agreed that the insurance company will not issue the contract prior to principal approval by the broker-dealer.

.07 Sharing of Information. Rule 2330 does not prohibit using the information required for principal review and approval in the issuance process, provided that the broker-dealer and the insurance company have agreed that the insurance company will not issue the contract prior to principal approval by the broker-dealer. For instance, the rule does not prohibit a broker-dealer from inputting information used as part of its suitability review into a shared database (irrespective of the media used for that database, i.e., paper or electronic) that the insurance company uses for the issuance process, provided that the broker-dealer and the insurance company have agreed that the insurance company will not issue the contract prior to principal approval by the broker-dealer.

Amended by SR-FINRA-2014-045 eff. Dec. 1, 2014.
 Amended by SR-FINRA-2012-027 eff. July 9, 2012.
 Amended by SR-FINRA-2011-065 eff. Dec. 5, 2011.
 Amended by SR-FINRA-2009-083 eff. Feb. 8, 2010.
 Amended by SR-FINRA-2008-019 eff. Feb. 8, 2010.
 Amended by SR-FINRA-2008-015 eff. April 17, 2008.
 Adopted by SR-NASD-2004-183 eff. May 5, 2008.

Selected Notices: 07-53, 09-32, 09-72.

VERSIONS

Dec 01, 2014 onwards



2341. Investment Company Securities

[The Rule](#)[Notices](#)

This version is valid from Sep 05, 2017 through Jun 29, 2020.

Amendments have been announced but are not yet effective. To view other versions open the versions tab on the right.

(a) Application

This Rule shall apply exclusively to the activities of members in connection with the securities of companies registered under the Investment Company Act; provided however, that Rule 2320 shall apply, in lieu of this Rule, to members' activities in connection with "variable contracts" as defined therein.

(b) Definitions

(1) The terms "affiliated member," "compensation," "cash compensation," "non-cash compensation" and "offeror" as used in paragraph (l) of this Rule shall have the following meanings:

(A) "Affiliated Member" shall mean a member which, directly or indirectly, controls, is controlled by, or is under common control with a non-member company.

(B) "Compensation" shall mean cash compensation and non-cash compensation.

(C) "Cash compensation" shall mean any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override or cash employee benefit received in connection with the sale and distribution of investment company securities.

(D) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of investment company securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(E) "Offeror" shall mean an investment company, an adviser to an investment company, a fund administrator, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act) of such entities.

(2) "Brokerage commissions," as used in paragraph (k), shall not be limited to commissions on agency transactions but shall include underwriting discounts or concessions and fees paid to members in connection with tender offers.

(3) "Covered account," as used in paragraph (k), shall mean (A) any other investment company or other account managed by the investment adviser of such investment company, or (B) any other account from which brokerage commissions are received or expected as a result of the request or direction of any principal underwriter of such investment company or of any affiliated person (as defined in the Investment Company Act) of such investment company or of such underwriter, or of any affiliated person of an affiliated person of such investment company.

(4) "Person" shall mean "person" as defined in the Investment Company Act.

(5) "Prime rate," as used in paragraph (d), shall mean the most preferential interest rate on corporate loans at large U.S. money center commercial banks.

(6) "Public offering price" shall mean a public offering price as set forth in the prospectus of the issuing company.

(7) "Rights of accumulation" as used in paragraph (d), shall mean a scale of reducing sales charges in which the sales charge applicable to the securities being purchased is based upon the aggregate quantity of securities previously purchased or acquired and then owned plus the securities being purchased. The quantity of securities owned shall be based upon:

(A) The current value of such securities (measured by either net asset value or maximum offering price); or

(B) Total purchases of such securities at actual offering prices; or

(C) The higher of the current value or the total purchases of such securities.