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Via E-mail: rule-comments@sec.gov

Ms. Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Rule Change by FINRA Relating to the Regulation of Underwriting Compensation in Public Offerings of Real Estate Investment Trusts and Direct Participation Programs
File No. SR-NASD-2005-114

Dear Ms. Morris:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the American Bar Association's (the "ABA") Section of Business Law[1] (the "Committee") in response to the request of the Securities and Exchange Commission ("SEC" or "Commission") for comments on the above-identified rule proposal by the Financial Industry Regulatory Authority, Inc. ("FINRA"), formerly the National Association of Securities Dealers, Inc. (the "NASD"), published for comment on January 28, 2008 (the "Revised Proposal").[2] It was prepared by the Committee's Subcommittee on FINRA Corporate Financing Rules.[3]

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association's House of

[1] References herein to "we" and "our" refer to the Committee.

[2] SEC Release No. 34-57199 (Jan. 25, 2008); 73 FR 5885 (Jan. 31, 2008).

[3] On August 1, 2007, the NASD changed its name to FINRA to reflect the consolidation of its regulatory functions with those of NYSE Regulation, Inc. The NASD rules, however, have not yet been revised to reflect this change and, therefore, we will continue to refer to the NASD rules for purposes of clarity.

Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, they do not represent the official position of the ABA Section of Business Law, nor do they necessarily reflect the views of all members of the Committee.

We welcome the opportunity to comment on the Revised Proposal and appreciate the amendments that were made to the original version of the proposal (the "Original Proposal") in response to earlier comments we submitted on August 22, 2006 (the "Original Comment Letter").[4] We continue to support the initiative of FINRA to amend the procedures for the review of public offerings of direct participation programs ("DPP" or "DPPs") and real estate investment trusts ("REIT" or "REITs") under NASD Conduct Rule 2810 ("Rule 2810") in order to clarify and codify the policies of FINRA with respect to the treatment of compensation, fees and expenses. We commend FINRA for revising the Original Proposal to:

- permit reimbursement of due diligence expenses on a non-accountable basis up to three percent of the offering proceeds;

- clarify that the issuer's organization and offering expense ("O&O") limitation applies only to those expenses deemed to be in connection with the public offering and reimbursed or paid for with offering proceeds;

- no longer apply the proposed amendments to unregistered dual employees; and

- exclude from underwriting compensation salaries that are paid to dual employee registered representatives who are compliance and back-office personnel or perform other administrative support functions that are clerical and ministerial in nature, including the "maintenance and monitoring of selling agreements and relationships with broker/dealers and accounts and account holders at broker/dealers."

Nonetheless, the practical application of the proposed amendments to REITs and DPPs continues to be problematic in certain respects with respect to a dual employee of a FINRA member. Moreover, we believe that FINRA should amend certain of the rule language to more accurately reflect the intended meaning of the relevant provision. Our comments are set forth below.

[4] The Original Proposal was published for comment in SEC Release No. 34-54118 (July 10, 2006); 71 F.R. 40569 (July 17, 2006).

Comments on the FINRA Revised Proposal to Amend Rule 2810

Underwriting Compensation of Dual Employees

The Revised Proposal would apply an "all-in" approach to include in the calculation of underwriting compensation any compensation from any source paid to a dual employee registered representative who either:

(a) engages in the solicitation, marketing, distribution or sales of DPP or REIT securities (*i.e.*, functions requiring registration under NASD Rule 1031); or

(b) receives transaction-based compensation.[5]

Notwithstanding the foregoing "all-in" approach, the Revised Proposal would permit a broker/dealer to provide information to the FINRA Corporate Financing Department that allocates the salaries and other non-transaction-based compensation of dual employees between the underwriting compensation, issuer's expense and unrelated compensation in the case of:

(a) a program or REIT with fewer than 10 people "engaged in wholesaling"; or

(b) a dual employee who is one of the top ten highest paid executives based on non-transaction based compensation.

We are concerned that the lack of clarity on the availability of the exceptions to the "all-in" approach will result in the kind of burdensome reviews that FINRA staff was hoping to avoid by adopting the limited exceptions to permit the submission of salary allocation information to FINRA. With additional clarification, we believe that the proposed exceptions will allow the salaries of certain of a broker/dealer's dual employees to be fairly allocated among underwriting compensation for the current offering, job functions on behalf of the issuer, unrelated job functions, compensation and functions related to other products sold by the broker/dealer, and clerical and ministerial activities.

Allocation of Salaries Between Offerings: In connection with FINRA's discussion of the treatment of dual employees, FINRA sets forth a policy in footnote 36 of the Revised Proposal ("Footnote 36" or the "Guidance") that if a dual employee receives compensation for services provided in connection with more than one public offering or for private placements, "payments to such employees may be reasonably allocated between the offerings based on the time periods in which the employee was engaged in the offerings, if they are distinct, or based on the relative size of the offerings." We appreciate that FINRA is seeking to provide guidance to FINRA members on the manner in which salaries and other payments to a member's registered representatives may reasonably be allocated between offerings of securities. However, we believe that the footnote standing alone is insufficient in confirming the scope of the intended application of the Guidance stated in the footnote. Set forth below are our views

[5] We understand that FINRA staff take the position that "transaction-based compensation" does not include an annual bonus.

on what we believe to be the intended application of the Guidance and our recommendations regarding its scope. We respectfully request that FINRA confirm whether our views are correct and otherwise clarify the Guidance as necessary in the SEC's approval order and in the FINRA Regulatory Notice announcing adoption of the Revised Proposal.

As an initial matter, we believe that Footnote 36 is intended to only apply to any salary and other non-transaction-based compensation received by a registered representative from a source other than the employer-FINRA member, since transaction-based compensation is automatically allocated between offerings. Since Footnote 36 is located at the end of a sentence that references the two exceptions, we are unsure whether FINRA intended the Guidance to apply only to dual employee registered representatives and also intended that it be available only to a dual employee that can rely on one of the exceptions. We believe that the Guidance should allow the allocation of the salary of any registered person that receives a salary from outside of the FINRA member, regardless of whether the representative is a dual employee of the FINRA member and the sponsor, issuer, or other affiliate or whether such a dual employee may rely on one of the exceptions. This approach would be compatible with long-standing staff review policies set forth in Rule 2710(c)(2)(B) and restated in proposed Rule 2810(b)(4)(B) to only include in the calculation of underwriting compensation those items of value that are "deemed to be in connection with or related to the distribution of the public offering." Thus, we hope that this footnote indicates that FINRA staff will continue to allow a FINRA member to fairly allocate the salaries of any registered representative that receives a salary from a source outside the member between underwriting compensation for the current offering and other products sold by the member.

Such an allocation of the salaries between different offerings is a far less complex process than the allocation of salaries of dual employees between issuer expenses, underwriting compensation, and other non-distribution functions that FINRA stated in the Original Proposal has been burdensome to FINRA staff. In such cases, the salaries received for functions related to other offerings or the operation of other DPPs or REITs can be easily distinguished from those received from the current DPP or REIT or its sponsor, adviser or other affiliate that is under review. Moreover, such an allocation would continue to conform to the proposed "all-in" approach by including in the calculation of underwriting compensation for the current offering, absent the availability of either of the two exceptions, the salary received by any dual employee of the FINRA member and of the issuer, sponsor or other affiliate in connection with the current offering.

The "Small Firm" Exception: The "small firm" exception is proposed to be available to "a dual employee of a program or REIT with fewer than ten people engaged in wholesaling." FINRA states in the Revised Proposal that the exception is intended to be available to "small companies," which we believe was a reference to a small DPP or REIT. We recommend that, instead, the exception should be available to a smaller FINRA member that has fewer than ten registered representatives engaged in wholesaling with respect to the DPP or REIT in order to avoid inclusion of any unregistered persons in the calculation. We understand that a FINRA member that would qualify for the

exception would be able to submit information regarding the allocation of the salaries of any number of dual employees. In addition, since the concept of a dual employee is no longer described in the Revised Proposal, we believe that language that previously was included in proposed Rule 2810(b)(4)(C)(ii)b. of the Original Proposal describing the concept of a "dual employee" should be included in the text of the rule. We recommend, therefore, that FINRA revise the exception to be available to "a dual employee of a member and the sponsor, issuer or other affiliate with respect to a program or REIT with fewer than ten registered representatives engaged in wholesaling."

We also believe it to be of vital importance that FINRA provide guidance on how the calculation of the number of "wholesalers" will be made in order to avoid the protracted and contentious reviews of offerings subject to Rule 2810 that the Revised Proposal was intended to address. The role of any FINRA member that is affiliated with a DPP or REIT is generally to act as "wholesaler" for the REIT or DPP by soliciting other FINRA members to offer the DPP or REIT securities to their customers. The term "wholesaler" could, therefore, apply to all registered representatives of the FINRA member. We believe that the calculation of "wholesalers" should include only those registered representatives directly contacting other FINRA members to solicit new selling agreements with respect to the specific offering. Thus, the calculation would not include registered representatives who solely monitor and manage selling agreements, have management responsibilities, or directly solicit selling agreements for other products sold by the FINRA member, or engage in any other clerical or ministerial activities. We believe that FINRA intended the exemption to apply to this latter and more limited category of registered persons.

The "Top Executives" Exception: The "top executives" exception is available to "a dual employee who is one of the top ten highest paid executives based on non-transaction based compensation in any program or REIT." FINRA states in the Release that the exception is intended to be available to the "ten highest paid executives in an Investment Program." We find the proposed rule and this explanation to be confusing since the exception appears to be available to dual employees who serve in the top ten executive positions in the DPP or REIT, regardless of whether such executives are dual employees. We understand that the exception is, in fact, intended to be available to a dual employee registered representative who is one of the top ten highest-paid dual employee executives of the DPP or REIT out of the total number of dual employee executives. In either case, the exception remains problematic as it: (1) focuses on the position of the dual employee in the DPP or REIT; [6] and (2) would not be available to those dual employees who perform functions for the sponsor or the adviser to the DPP or REIT, rather than the specific DPP or REIT.

We believe that FINRA should expand the exception to be available to the top ten highest paid dual employees of the FINRA member and the sponsor, issuer or other affiliate who are registered representatives of the FINRA member, as determined by the

[6] The term "executive" should not be relevant. We believe that the salary and bonus compensation of the dual employee should qualify a dual employee for the exception rather than the person's title.

non-transaction-based compensation of the dual employees in connection with the DPP or REIT, regardless of whether the dual employees are executives of the DPP or REIT. Therefore, we believe that the exception would operate as follows. If a FINRA member has 20 salaried registered representatives, of which 12 are dual employees of the DPP, REIT, or the adviser to or sponsor of the DPP or REIT under review, the ten highest-paid dual employee registered representatives in connection with the DPP or REIT would be permitted to rely on the exception. Thus, it would not matter where the compensation of those ten dual employees fell within the 20 total salaried employees, but rather that they represented the ten highest paid dual employees in the case of the specific DPP or REIT. Further, it would not matter whether the dual employees received compensation from the DPP or REIT or the sponsor or the adviser to the DPP or REIT.

We recommend that FINRA revise the exception to provide that it is available to "the ten highest paid dual employees of a member and the sponsor, issuer or other affiliate, as determined by the non-transaction-based compensation of the dual employee received in connection with the DPP or REIT."

Offering Proceeds and Trail Commissions

As stated in our Original Comment Letter, we believe that proposed Rule 2810(b)(4)(B)(ii) appears to indicate that a FINRA member's underwriting compensation is composed of the "offering proceeds." The close proximity of the terms "offering proceeds" and "trail commissions" is also confusing, because "offering proceeds" is a source of compensation whereas a "trail commission" is a specific item of compensation that is payable from the operation of the DPP or REIT. Further, we believe that there should be a comma added after the words "trail commissions" and a comma deleted after the word "thereof" so that the meaning of the provision is clear that it shall be deemed an unfair arrangement if "The total amount of all items of compensation from whatever source . . .payable to underwriters, broker/dealers, or affiliates thereof exceeds" the 10 percent compensation guideline. We recommend that the text be revised as follows:

> (i) The total amount of all items of compensation from whatever source, including <u>compensation paid from</u> offering proceeds and <u>in the form of</u> "trail commissions," to underwriters, broker/dealers, or affiliates thereof exceeds an amount that equals ten percent of the gross proceeds of the offering;

Issuer Expenses

Reimbursement From Offering Proceeds: We also recommend that proposed Rule 2810(b)(4)(C)(i) be revised to clarify that the term "that are reimbursed or paid for with offering proceeds" applies to all issuer expenses, not just the specific item of "overhead expenses." We suggest that the provision be revised as follows:

> (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:

We also suggest that proposed Rule 2810(b)(4)(C)(i)a. be revised to add "and" before "generating advertising and sales materials."

Services for the Sponsor: We continue to be confused by the meaning of proposed Rule 2810(b)(4)(C)(i)c., which would include in the calculation of issuer expenses under subprovision c. the "salaries and non-transaction-based compensation paid to employees or agents of the sponsor for performing services for the sponsor . . . ." We stated in the Original Comment that "we believe that FINRA intended for subprovision c. to cover only the salaries of those of the sponsor's employees who are engaged in the activities referred to in subprovision a. (*i.e.*, assembling and mailing offering materials, etc.)." However, the Revised Proposal does not, in response to our comment on the Original Proposal, provide an explanation of the services that are intended to be covered by this provision.[7] The intent of this provision, therefore, remains unknown. In comparison, the other subprovisions are clear in describing the categories of distribution-related activities that may be included in the calculation of issuer expenses, if reimbursed from offering proceeds and in connection with the distribution of the offering. Unless FINRA can explain the "services" intended to be covered by this provision, we urge FINRA to delete the provision in order to avoid unintentional non-compliance by FINRA members.

Underwriting Compensation

Under proposed Rule 2810(b)(b)(C)(ii)b. and c., the Revised Proposal would include in underwriting compensation any "payments . . . [t]o any registered representative of a member who receives transaction-based compensation in connection with the offering . . . [or] is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities. . ." While we understand the intent of these provisions, we believe that the text would treat payments by a FINRA member to its registered representatives as underwriting compensation, thus counting such payments twice, *i.e.*, when the firm receives the payments under proposed Rule 2810(b)(4)(C)(ii)a. and when it reallows the payments to its registered representatives under subprovisions b. and c. We recommend that the rule be clarified by inserting the words "from a source outside the member" in front of each provision. Thus, in each case, the provision would be revised to include in underwriting compensation payments "From a source outside the member to any registered representative . . ."

* * *

We appreciate the SEC's republication of the Revised Proposal for comment and hope that these comments will be helpful to the Commission in its consideration of the Revised Proposal. Certain of the comments that we have submitted make substantive recommendations, while others more are technical in nature. In both cases, we believe

[7] *See*, Original Comment, page 12.

that it is important that FINRA's Revised Proposal be amended as we have recommended in order for the revised rules to operate effectively as intended by FINRA. We would be pleased to discuss any aspects of these comments with the staffs of FINRA or SEC. Questions may be directed to Suzanne E. Rothwell (202) 371-7216, Chair, FINRA Corporate Financing Rules Subcommittee.

Respectfully submitted,

/s/ Keith F. Higgins

Keith F. Higgins, Chair
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