



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
April 17, 1998

Mr. Frank Zarb  
Chairman and Chief Executive Officer  
NASD, Inc.  
1735 K Street, N.W.  
Washington, D.C. 20006-1500

Dear Frank:

As you know, the 1995 Report of the Committee on Compensation Practices identified compensation "best practices" used in the securities industry to reduce conflicts of interest and align the interests of the client and its broker. The Report played an important role in drawing attention to the need to address conflicts of interest between brokers and their clients, particularly to the extent these conflicts are a result of broker compensation practices.

After its issuance in April 1995, many leading firms swiftly endorsed the Report and the best practices it described. Important compensation practices outlined in the Report have been implemented by many firms, such as prohibiting single-product and short duration sales contests, leveling compensation rates for proprietary and non-proprietary products and principal and agency trades, introducing stock options or stock purchase plans as part of compensation packages, and paying recruits just entering the profession a fixed salary for an extended training or mentoring period. The industry should be applauded for adopting these meaningful changes voluntarily.

Nevertheless, it is apparent that more needs to be done. One of the problem areas identified by the Report is the use of up-front bonuses and accelerated payouts to attract experienced, high-producing brokers from competing firms. Similar concerns are raised with other types of compensation that encourage brokers to increase the level of trading activity in customer accounts during a particularly lucrative time, even if this increased activity is not in the customers' best interests.

Despite the concerns expressed in the Report about these types of incentives, most firms continue to engage in some of these forms of compensation. I have been told that competitive pressures may be making it difficult for firms to eliminate these arrangements altogether. Even though firms may want to stop offering these incentives, their continued use by other firms means that those other firms may lure away their brokers.

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Accordingly, I urge you and the NASD to formally consider whether up-front bonuses, accelerated payouts, or other forms of compensation are so rife with conflicts of interest that they should be disclosed to customers or, if need be, prohibited. You have proposed rules limiting mutual fund sales contests, and sought comments on cash compensation for sales of mutual funds and variable contract securities. I believe the conflicts present in those situations are active also in other compensation practices.

Regulation of compensation should never be undertaken lightly. Yet experience suggests that the time may have come for stronger measures. I also believe that further initiatives in this area would complement the NASD's existing ambitious agenda to protect investors and promote industry professionalism.

I look forward to working with you on these important and difficult questions.

Sincerely,

A handwritten signature in black ink, appearing to read 'A. Levitt', with a stylized flourish at the end.

Arthur Levitt