



AMERICAS

February 23, 2006

VIA ELECTRONIC MAIL

Barbara Z. Sweeney
Office of Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

**Re: NASD Notice to Members 06-06
IM-3060 Related to Gifts and Business Entertainment**

Dear Ms. Sweeney:

Thank you in advance for providing us with an opportunity to comment on the proposed interpretive materials to NASD Rule 3060 (the "IM"), as described in NASD Notice to Members 06-06.¹ We applaud the efforts of the NASD in attempting to eliminate the potential for registered persons of member firms from acting in any manner other than in the best interests of their clients and by seeking to eliminate potential conflicts of interest. However, it is our strong belief that any new regulatory requirement, or amendments to existing requirements, should be reasonably designed to achieve a clearly articulated purpose and that the proposal not be so broad as to have a chilling effect on legitimate business activities or innovation. In other words, the benefits of any regulatory requirement should not be significantly outweighed by the burden it would impose on the financial services industry. In addition, any rule being considered for adoption by the NASD must be clear and unambiguous so that member firms and others in the industry reasonably are able to comply.

I. Introduction

As opposed to merely interpreting NASD Rule 3060, the IM substantially amends current NASD Rule 3060 without the benefit of review and comment by the Securities and Exchange Commission (the "SEC"). In doing so, the IM would impose significant new recordkeeping obligations on member firms without any basis to do so within Rule 3060. The impact of the IM would be disproportionately felt by wholesale broker-dealers and other broker-dealers whose principle business partners are of a corporate or institutional nature. We also believe that the proposed IM, as described in the Notice, creates a high degree of ambiguity and uncertainty as to the application of NASD Rule 3060 which creates the potential of an "uneven playing field" within the securities industry.

¹ NASD Notice to Members 06-06 (Jan. 2006) (the "Notice").

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II. The Proposed IM Inappropriately Imposes Significant New Obligations on NASD Member Firms

A. The Proposed IM Inappropriately Circumvents the Standard Rule-Making Process

The proposed IM serves as a fundamental re-interpretation of current NASD Rule 3060 that significantly alters the import and effect of the current rule without any explanation of how the proposed changes reasonably and fairly can be implied under the rule. Rule 3060 currently prohibits gifts and gratuities where such payment is “in relation to the business of the recipient’s employer.” Under Rule 3060, the NASD has the burden of showing that where a gift is made to a person who also is an employee of an entity, the gift is directly related to the business of the recipient’s employer in order to establish a violation of Rule 3060.² Under the proposed IM, the NASD shifts the burden of proof to member firms by imposing a standard that a gift would violate Rule 2110 if it could be “reasonably judged to have the like effect of causing, such employee to act in a manner that is inconsistent with the best interests of the customer.”³ This shift in the burden of proof is particularly disturbing when done through an IM interpreting Rule 2110 rather than a rule proposal to amend Rule 3060 which would be subject to review by the SEC, including an analysis as to whether the proposed rule would present an unfair burden on competition.

Further, under the proposed IM, *anything of value* to any “employee” would be prohibited if it would “likely” have the effect of causing the employee to act against the best interests of the employer.⁴ The proposed IM apparently would include in the definition of “customer” virtually any kind of entity that currently has, or might in the future have, an account with the member and an “employee” as any person who has any relationship with the “customer.”⁵ The proposed IM, as currently drafted, does not limit the definition of “employee” to only those persons: who have control over the account of the customer; or have the ability to influence the selection of a broker-dealer by their employer.⁶ Thus, any person who, regardless of their role or position with their employer, is employed by any entity that now has, or in the future may have, an account with a broker-dealer or “*is otherwise a customer of the member [firm] for the purposes of investment banking or securities business*”⁷ would be considered an “employee” under the interpretation. Conceivably, even a relatively low-level, clerical employee of a business partner of a member firm could fall within the framework of the proposed IM. It is hard to envision what public interest is served by such an overly broad definition.

It is worth noting that, as written, Rule 3060 prohibits gifts and gratuities *in excess of \$100* given “*in relation to the business of the employer.*” The qualifying

² See, e.g., *In the Matter of Albert Fosha*, SEC Release No. 34-22815 (January 21, 1986).

³ Notice at 3.

⁴ *Id.*

⁵ *Id.* at 6.

⁶ *Id.*

⁷ *Id.*

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language in Rule 3060 should be retained as it provides meaningful guidance and lends a degree of reasonableness to the Rule that would be lost under the proposed IM. By omitting this qualifying language, the proposed IM inappropriately and significantly expands the reach of Rule 3060 through an interpretation of Rule 2110 without any apparent basis upon which to do so under Rule 3060.⁸

As described below, the standards for determining the propriety of business entertainment under the IM are, to say the least, ambiguous and vague.

- From the IM, it is not clear whose “judgment” is to be used in determining whether or not a gift or entertainment is inappropriate. There is no “reasonable person” standard in the proposal and it is not clear whether it is the judgment of the “trier of fact” or that of a reasonable person in the securities industry or even that of someone in the same position as the employer.
- There is no standard in the Notice for determining whether the resultant conduct by the employee receiving the gift or entertainment would be “inconsistent with the best interests of the customer.” If the resultant conduct constitutes a securities transaction that is not suitable for a retail customer, the NASD already has a suitability rule to govern the situation. On the other hand, if the resultant conduct is that the employer opens an account with a particular broker-dealer, the proposed IM is overreaching by substituting the judgment of the regulator for that of the employer and its personnel in determining where a brokerage account should be opened by the employer.⁹
- The application of the interpretation of “business entertainment” is somewhat ambiguous. In the Notice, the NASD states that business entertainment provided to “employees, agents or representatives” of a customer are covered by Rule 3060. Presumably, although contrary to advice previously given by NASD staff, this would mean that the \$100 limitation of Rule 3060 would apply to such entertainment. Nevertheless, the Notice and proposed IM do not require that the \$100 standard be applied to such entertainment. Either business entertainment is covered by Rule 3060 or it is not.

⁸ In this regard, the proposed IM would appear to be in conflict with Rule 3060 which is not being amended.

⁹ The IM initially states that a member should not “act in a manner contrary to the best interests of a customer in the conduct of business with or for such customer” This would appear to suggest that the IM deals with conduct relating to the securities business. The Notice, *supra n.* 1 at 3. The IM goes on to state, however, that a broker-dealer could violate 2110 if it provided entertainment that would be illegal for the customer under virtually any rule of any governmental authority. *Id.* at 4. This is overreaching in that a broker-dealer cannot reasonably be held to know all rules applicable to all businesses outside of the securities industry.

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Finally, with respect to both gifts and business entertainment, we are deeply troubled by footnote 5 of the Notice. In that footnote, the NASD staff essentially states that any gift or entertainment provided to a natural person who also happens to be an employee, agent or representative of a "customer" would be covered by the prohibitions of Rule 3060 and the proposed IM. As previously stated, Rule 3060 requires that the provision of a gift be "in relation to the business of the employer" before it becomes subject to the rule. Footnote 5, by its language, substantially expands the prohibitions of the Rule to any situation in which a person has any relationship to an entity that is a "customer" whether or not there exists a separate personal relationship by that person with the representative or whether the representative even knows of the existence of a separate customer account. Taken to its extreme, the footnote would prohibit personal gifts for a wedding or other personal events and could even apply to gifts to family members who happen to be employees of "customers." It is highly questionable as to how such prohibitions could be fairly said to be in the public interest and constitute appropriate rulemaking.

B. The Proposed Policies and Procedures Requirements Are Unworkable and Inappropriate

The IM would impose significant new recordkeeping obligations on NASD member firms that appear impracticable and inappropriate. As described in the Notice, each member firm would be required to maintain detailed records relating to business entertainment and also would be required to make such records available to customers.¹⁰ As currently written, Rule 3060 imposes no such recordkeeping requirement and there is no basis within Rule 3060 from which this requirement can be derived. As described more fully below, the proposed recordkeeping requirement seems impracticable and inappropriate.

- Because the terms "business entertainment" and "employee" are defined so broadly in the IM, it virtually would be impossible for a member firm to determine which individual client might fall within the provisions of Rule 3060 as the individual client accepting the entertainment, may not know that the client's employer maintains an account with the broker-dealer. As a result, the member firm and its registered representatives conceivably would be required to maintain records of business entertainment given to every individual employee for fear that they might inadvertently provide entertainment to an individual client whose employer (or an affiliate of such employer) is a client of the member firm. Thus, it would seem appropriate to more narrowly tailor the definition of an employee under the IM.
- There apparently is no limitation on the value of the "business entertainment" that would require recordkeeping. Indeed, the IM seems to

¹⁰ *Id.*

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apply to “anything of value”.¹¹ Thus, buying an individual breakfast at a business conference that both the recipient and the registered representative happen to be attending would seem to fall within the IM regardless of whether the event is sponsored by the broker-dealer if the recipient happens to be an employee of a “customer.” No one could reasonably construe such activity as being of interest to most employers. For those employers where such conduct may be an issue, such as unions or pension plans, there are separate regulatory and statutory requirements that would govern the conduct of the subject employee. It is unclear what additional public benefit would be provided under this scenario.

In addition to the foregoing, the recordkeeping requirement described in the Notice seemingly is in conflict with the cash and non-cash provisions of NASD Rules 2820 and 2830 which do not require recordkeeping for permissible business entertainment. Thus, it would seem more appropriate, as described above, to amend Rule 3060, if that is indeed the aim of the NASD, through the standard rulemaking process.

III. Impact on Registered Representatives of Wholesale Broker-Dealers

A. Disproportionate Impact on Legitimate Business Activities of Wholesale Broker-Dealers

While the IM has the potential to significantly alter the import and interpretation of NASD Rule 3060 as a general matter, the impact of the proposed re-interpretation would have a disproportionate impact on the legitimate business activities of wholesale broker-dealers and other member firms doing business largely with institutional and other business partners as opposed to individual customers and contradicts existing NASD Rules. As noted by the NASD, the “overriding principle of the proposed IM is that a member [firm] or its associated persons should not do or give anything of value to an employee of a customer that is intended to . . . have the likely effect of causing such employee to act in a manner that is inconsistent with the best interests of the customer.”¹² As the NASD also noted in the Notice, the current standard for determining whether business entertainment is inappropriate is whether or not such entertainment is either “so frequent . . . [or] so excessive as to raise any question of propriety.”¹³ Although the Notice would do away with this standard in connection with business entertainment, NASD Rule 2820(g)(4)(b) explicitly retains this standard for purposes of non-cash compensation given to registered persons in connection with the distribution of securities products.

At best, it would seem inconsistent for non-registered employees of the business partners of wholesale broker-dealers to be subject to a more restrictive standard than registered persons of member firms who directly interact with retail customers.

¹¹ *Id.* at 6.

¹² *Id.* at 3.

¹³ *Id.* at 2. The Notice correctly points out that the previous standard was derived from the non-cash compensations rules applicable to variable insurance and mutual fund products.

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Often times, representatives of wholesale broker-dealers interact exclusively with senior level employees. In such a highly competitive and closely scrutinized environment, it would seem beyond reason that such senior employees would jeopardize the competitive position of their broker-dealer based upon an occasional dinner with an offeror. At the end of the day, each broker-dealer is seeking to offer a competitive range of products to meet the needs of its clients.

As proposed, the IM likely will have a chilling impact on the degree to which wholesale broker-dealers are able to service their institutional corporate clients. For instance, as part of the corporate market for 401(k) plans, administrators of such plans often are encouraged to participate in meetings with the investment committee and other internal employees who are responsible for the oversight of such plans. Under the IM, regardless of whether these persons are registered with the NASD, the registered representative seemingly would be severely limited in his or her ability to provide even so much as light breakfast fare at such meetings. Furthermore, it is worth noting that members of an investment committee and others associated with a 401(k) plan likely would be deemed "fiduciaries" within the meaning of such term under the provisions of the Employee Retirement Income Security Act of 1974, as amended, ("ERISA") and would be subject to the strict penalties and requirements applicable to fiduciaries under ERISA. Rather than imposing arbitrary restrictions on the conduct of registered representatives in such a context, it would seem that the interests of the NASD, the financial services industry and the investing public are best served by promoting close working relationships between member firms and all of their clients, including institutional and corporate clients.

B. Access to Training and Other Educational Opportunities

It is unclear whether or not the re-interpretation of NASD Rule 3060 is intended to further prohibit offerors from providing training materials, among other things, to employees of their business partners and others. As noted in the IM, the term "business entertainment" would include "business entertainment offered in connection with an educational event or business conference . . ."¹⁴ It is our fervent belief that employees of business partners and other customers should be afforded access to as many educational and training opportunities as is reasonably possible. In our opinion, it is critical that, in the best interests of consumers, wholesale broker-dealers and offerors have the flexibility to continue to support bona fide training and educational initiatives. Accordingly, we urge the NASD not to impose any additional limitations on access to such training and educational opportunities by registered or non-registered persons whether provided by offerors or otherwise.

¹⁴ *Id.* at 6.

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C. Access to Business Entertainment Records

In the case of wholesale broker-dealers, it is difficult to see what purpose would be served in providing access to the customers of such broker-dealers to the business entertainment records that are required under the proposed IM. As noted above, the IM requires member firms to maintain detailed records of business entertainment expenses and to make such information available to customers upon request.¹⁵ The stated intent of the NASD in providing customer access to the records of member firms is to “allow the customer to verify and review the types of business entertainment received by employees . . . as additional protection against awarding business entertainment that causes . . . the recipient . . . to act in a manner that is inconsistent with the best interests of the customer.”¹⁶

In the case of wholesale broker-dealers, we believe that the rationale behind providing access to broker-dealer records is somewhat misguided. Since wholesale broker-dealers generally have no contact with public customers, the “customer” in the case of a wholesale broker-dealer that would have access to the information required under the IM would be the retail broker-dealer who is the business partner of the wholesale firm, as opposed to the actual investor client of the retail firm. The information provided by the wholesale broker-dealer to the retail broker-dealer would not provide any additional information to public customers that would allow the customer to determine whether or not a member firm was acting in the best interests of the customer.

We also would observe that the retail business partners of wholesale broker-dealers are themselves NASD member firms. As such, each retail broker-dealer has its own recordkeeping obligations under the rules of the NASD and SEC. An argument can be made that allowing the retail broker-dealer to have access to the business records of the wholesale firm would provide the retail broker-dealer with an opportunity to avoid, at least in part, certain of its own recordkeeping obligations by relying on the records maintained by the wholesale firm.

D. Impact of Inconsistent Standard

By failing to establish specific criteria for the policies and procedures, wholesale broker-dealers will be subject to varying interpretations by their corporate and institutional business partners that also are NASD member firms. The IM provides member firms with a great degree of latitude with regard to establishing policies and procedures relative to business entertainment.¹⁷ Indeed, the IM even would permit a member firm to vary its policies and procedures with respect to business entertainment with respect to different types of events and even from recipient to recipient.¹⁸

¹⁵ *Id.* at 4

¹⁶ *Id.* at 8.

¹⁷ *Id.* at 3.

¹⁸ *Id.*

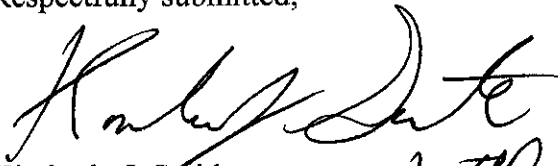
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As is the case with the compensation rules set forth in NASD Rules 2820 and 2830, wholesale broker-dealers will find themselves forced to comply with policies and procedures of their business partners governing receipt of business entertainment that vary widely from firm to firm. As a consequence, the wholesale broker-dealer may be forced to adopt an overly restrictive policy with regard to business entertainment that could place the firm at a competitive disadvantage relative to other member firms with less restrictive policies and procedures or who do business with firms with less restrictive policies. Although the intent of the flexibility may have been to allow member firms to tailor the policies and procedures required under the IM to fit their individual needs and circumstances, the resulting ambiguity has the potential of creating a less than even playing field within the industry.

* * *

For the reasons set forth above, we respectfully request that the NASD reconsider the issuance of the proposed IM. Specifically, we suggest that is more appropriate to amend Rule 3060 through the formal rulemaking process as opposed by means of issuing the proposed IM. As presented, the proposed IM imposes significant recordkeeping and other burdens on member firms due to its lack of specificity and overly broad nature. In addition, the proposed IM likely would have a chilling impact on the legitimate business activities of wholesale broker dealers in relation to their corporate and institutional business partners. Therefore, we would encourage the NASD to articulate more objective and less ambiguous standards in connection with any proposed amendment of Rule 3060 that are more closely tied to legitimate purposes than those set forth in the proposed IM.

Respectfully submitted,



Kimberly J. Smith
Deputy General Counsel
ING US Financial Services

Submitted on behalf of:
Directed Services, Inc.
ING Americas Equities, Inc.
ING Financial Advisors
ING Funds Distributors, Inc.
ING Life Insurance and Annuity Company
ING USA Annuity and Life Insurance Company
Reliastar Life Insurance Company
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Security Life of Denver Insurance Company