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Page 1 of 55

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2006 - 044
Amendment No. 3

Proposed Rule Change by National Association of Securities Dealers

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☐	☑	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

- ☐ 19b-4(f)(1)
- ☐ 19b-4(f)(2)
- ☐ 19b-4(f)(3)
- ☐ 19b-4(f)(4)
- ☐ 19b-4(f)(5)
- ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name	Gary	Last Name	Goldsholle
Title	Vice President and Associate General Counsel		
E-mail	gary.goldsholle@finra.org		
Telephone	(202) 728-8104	Fax	(202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 01/02/2008

By Gary L. Goldsholle
(Name)

Vice President and Associate General Counsel
(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Gary Goldsholle,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) is filing with the Securities and Exchange Commission ("SEC" or "Commission") Amendment No. 3 to SR-NASD-2006-044 to adopt Interpretive Material to NASD Rule 3060 to require members that engage in business entertainment to adopt policies and procedures addressing business entertainment. This amendment to SR-NASD-2006-044 revises the proposed rule change as proposed in the original filing and previous amendments.[2] The purpose of Amendment No. 3 is to address the comment letters the Commission received in response to the publication of the proposed rule change in the Federal Register[3] and to propose amendments responsive to the comments where appropriate. Amendment No. 3 also sets forth a new proposed effective date.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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1 15 U.S.C. 78s(b)(1).

2 SR-NASD-2006-044 was originally filed with the Commission on April 11, 2006. Amendment No. 1, which replaced and superseded the original rule filing in its entirety, was filed on April 17, 2007. Amendment No. 2, filed on May 1, 2007, was a partial amendment submitting an exhibit that showed the changes in the proposed rule text between the original filing and Amendment No. 1.

3 See Securities Exchange Act Release No. 55765 (May 15, 2007), 72 FR 28743 (May 22, 2007) (Notice of Filing of SR-NASD-2006-044).

IM-3060. Business Entertainment

The NASD Board of Governors is issuing this interpretation concerning the obligations of a member in connection with any business entertainment of a customer representative. This interpretation does not apply to any non-cash compensation that falls within Rule 2820(g) or Rule 2830(l) (i.e., entertainment provided by offerors to associated persons of a member in connection with the sale and distribution of variable contracts or investment company securities). This interpretation does not apply to any member that does not engage in business entertainment. For any member that engages in business entertainment, this interpretation applies only with respect to business entertainment provided to customer representatives. This interpretation supersedes any prior interpretive letters or statements of NASD staff regarding business entertainment under Rule 3060.

(a) General Requirements

No member or person associated with a member shall, directly or indirectly, provide any business entertainment to a customer representative pursuant to the establishment of, or during the course of, a business relationship with any customer that is intended or designed to cause, or would be reasonably judged to have the likely effect of causing, such customer representative to act in a manner that is inconsistent with:

(1) the best interests of the customer; or

(2) the best interests of any person to whom the customer owes a fiduciary duty.

(b) Definitions

For purposes of this interpretation, the following definitions shall apply:

(1) The term "customer" means:

(A) a person that maintains a business relationship with a member via the maintenance of an account, through the conduct of investment banking, or pursuant to other securities-related activity; or

(B) a person whose customer representative receives business entertainment for the purpose of encouraging such person to establish a business relationship with the member by opening an account with the member or by conducting investment banking or other securities-related activity with the member.

(2) The term "customer representative" means a person who is an employee, officer, director, or agent of a customer, unless such person is a family member of the customer.

(3) The term "family member" means a person's parents, grandparents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, children, grandchildren, cousin, aunt or uncle, and niece or nephew.

(4) The term "institutional customer" means a customer that meets the definition of "institutional account" in Rule 3110(c)(4).

(5) (A) The term "business entertainment" means any social event, hospitality event, sporting event, entertainment event, meal, leisure activity, or event of like nature or purpose regarding an existing or prospective customer relationship, including business entertainment offered in connection with a charitable event, educational event or

business conference, as well as any transportation or lodging related to such activity or event, in which an appropriate associated person of a member accompanies a customer representative.

(B) If a customer representative is not accompanied by an appropriate associated person of the member, any expenses associated with the business entertainment will be considered a gift under Rule 3060 unless exigent circumstances make it impractical for an associated person of the member to attend. All instances where such exigent circumstances are invoked must be clearly and thoroughly documented and be subject to the prior written approval of a designated supervisory person or, in very limited circumstances where such prior approval cannot reasonably be obtained, to a prompt post-event review to be conducted and documented by such supervisory person.

(C) Anything of value given or provided to a customer representative that does not fall within the definition of "business entertainment" is a gift under Rule 3060.

(D) In valuing business entertainment expenses pursuant to this interpretation, a member's written policies and procedures must specify the methodology to be used by the member to calculate the value of business entertainment. In general, business entertainment expenses should be valued at the higher of face value or cost to the member.

(c) Written Policies and Procedures

(1) Each member must have written policies and supervisory procedures

that, with respect to business entertainment provided to customer representatives of institutional customers:

(A) define forms of business entertainment that are appropriate and inappropriate using quantitative and/or qualitative standards that address the nature and frequency of the entertainment provided, as well as the type and class of any accommodations or transportation provided in connection with such business entertainment; and

(B) impose either specific dollar limits on business entertainment or require advance written supervisory approval beyond specified dollar thresholds.

(2) Each member must have written policies and supervisory procedures that, with respect to business entertainment provided to customer representatives of all customers:

(A) are designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived to be intended as, an improper quid pro quo or that could otherwise give rise to a potential conflict of interest or undermine the performance of a customer representative's duty to a customer or any person to whom the customer owes a fiduciary duty;

(B) require appropriate training and education for all personnel who supervise, administer, or are subject to the written policies and procedures; and

(C) make clear that anything of value given or otherwise provided

to a customer representative that does not fall within the definition of "business entertainment" is a gift under Rule 3060.

(3) A member's written policies and procedures may distinguish, and set specifically tailored standards for, business entertainment in connection with events that are deemed to be primarily educational, charitable, or philanthropic in nature, provided that such standards comply with the requirements of this interpretation and are explicitly addressed in the written policies and procedures.

(d) Recordkeeping

(1) Each member's written policies and procedures must require the maintenance of detailed records of business entertainment expenses provided to any customer representative of an institutional customer and must include provisions reasonably designed to prevent associated persons of the member from circumventing the recordkeeping requirements in contravention of the spirit and purpose of this interpretation.

(2) Each member's written policies and procedures must require that, upon an institutional customer's written request, the member will promptly make available to the institutional customer any business entertainment records regarding business entertainment provided to customer representatives of that institutional customer.

(e) Exemption for Members with Business Entertainment Expenses Below $7,500

A member whose business entertainment expenses in the course of its fiscal year are below $7,500 shall be subject only to paragraphs (a), (b), and (c)(2) of this

interpretation. Each member that relies on this exemption must evidence that its business entertainment expenses are below the $7,500 threshold.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on November 20, 2005, which authorized the filing of the rule change with the SEC. The Board of Governors of NASD had an opportunity to review the proposed rule change at its meeting on December 1, 2005. No other action by FINRA is necessary for the filing of the proposed rule change.

The effective date of the proposed rule change will be one year following Commission approval. FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

This Amendment No. 3 to SR-NASD-2006-044 responds to the comments received by the Commission in response to the notice of proposed rulemaking published in the Federal Register on May 22, 2007 regarding proposed new IM-3060. This Amendment No. 3 also makes several amendments to the text of the proposed rule change in response to those comments and establishes a new effective date for the proposed rule change. FINRA (then known as NASD) proposed IM-3060 after receiving

member requests for more guidance on the rules concerning gifts and business entertainment following numerous press reports of enforcement actions regarding gifts and gratuities. In response to these requests, FINRA is proposing to adopt interpretive material to NASD Rule 3060 that outlines the policies and procedures that a member must adopt in connection with its business entertainment practices. As proposed, IM-3060 would only apply to member firms that engage in business entertainment.

The Commission received 29 comment letters in response to the proposed rulemaking.[4] While many of the commenters expressed overall support for the proposed rule change, all of the commenters expressed concerns regarding particular provisions of

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[4] Letter from Royal Alliance Associates dated June 22, 2007 ("Royal Alliance Letter"); Letter from Lehman Brothers, Inc. dated June 15, 2007 ("Lehman Letter"); Letter from ABA Securities Association dated June 12, 2007 ("ABASA Letter"); Letter from Commonwealth Financial Network dated June 12, 2007 ("Commonwealth Letter"); Letter from Financial Services Institute dated June 12, 2007 ("FSI Letter"); Letter from Great American Advisors dated June 12, 2007 ("GAA Letter"); Letter from Pace Investor Rights Project dated June 12, 2007 ("Pace Letter"); Letter from 1st Global Capital Corp. dated June 11, 2007 ("1st Global Letter"); Letter from Bank of America Corporation dated June 11, 2007 ("BofA Letter"); Letter from Investment Company Institute dated June 11, 2007 ("ICI Letter"); Letter from National Association of Independent Broker-Dealers dated June 11, 2007 ("NAIBD Letter"); Letter from Securities Industry and Financial Markets Association dated June 11, 2007 ("SIFMA Letter"); Letter from T. Rowe Price Investment Services, Inc. dated June 8, 2007 ("T. Rowe Price Letter"); Letter from Coastal Securities dated June 1, 2007; Letter from Judith Schapiro dated May 17, 2007.

In addition to receiving the 15 letters cited above, the Commission received 14 copies of a form comment letter referred to herein as the "Type A Letter." In addition, the Commission received a comment letter from the Bond Market Association ("BMA") dated July 13, 2006, which predates the filing of Amendment No. 1 and Amendment No. 2. Because the BMA merged with the Securities Industry Association to form the Securities Industry and Financial Markets Association ("SIFMA"), and SIFMA filed a comment letter following the publication of the proposed rule filing in the Federal Register, this Amendment No. 3 does not address the issues raised in the BMA letter.

the proposed rule change. FINRA staff's response to the comment letters is provided below.

Response to Comments Concerning Definitions

Many commenters expressed concern over the breadth of the proposed rule and, in particular, the broad definitions of the terms "customer" and "customer representative." For example, several commenters suggested that the term "customer" be limited to institutional accounts because the abuses that the proposed rule change seeks to address occur more often when customer representatives of institutional customers are involved, and firms are substantially less likely to engage in abusive business entertainment practices with respect to small accounts.[5] FINRA agrees with those commenters that larger accounts present a greater risk of abusive business entertainment practices than the risks posed by smaller accounts. Although FINRA believes that portions of the proposed rule change should apply to all firms that engage in business entertainment and should apply to all customers, FINRA believes it is appropriate to limit the application of certain provisions of the proposed rule to business entertainment provided to customer representatives of customers, or potential customers, that meet the definition of "institutional account" in NASD Rule 3110(c)(4).[6] Thus, under the

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5 See 1st Global Letter; Commonwealth Letter; FSI Letter; GAA Letter; Royal Alliance Letter; Type A Letter.

6 NASD Rule 3110(c)(4) defines an institutional account as "(A) a bank, savings and loan association, insurance company, or registered investment company; (B) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (C) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million."

amended proposed rule, paragraphs (c)(1) and (d) apply only to business entertainment provided to customer representatives of institutional customers.

One commenter suggested that the definition of "customer" was so broad that members could not make risk-based determinations and choose the customers to which the business entertainment policies and procedures should apply.[7] FINRA does not believe that certain customers should be wholly excluded from a member's business entertainment policies and procedures. FINRA believes that the current language of the proposed rule already provides sufficiently flexibility to allow members to design their policies and procedures such that business entertainment provided to certain customers is subject to more rigorous oversight than business entertainment provided to lower-risk customers.[8] In addition, as noted above, the proposed rule has been amended so that members are required to comply with paragraphs (c)(1) and (d) only to the extent they

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7 See Lehman Letter. In a similar vein, the commenter also suggested that supervisory pre-approval be allowed to "kick in" once a cumulative threshold of spending on a particular customer is reached. FINRA believes that, under the current language of the proposed rule, such a policy would already be permitted under paragraph (c)(1)(C).

8 FINRA has also been asked about natural persons who are both customers and customer representatives. As discussed in footnote 5 of NASD Notice to Members 06–06, and as noted in Amendment No. 1, natural persons who are both natural person customers and customer representatives should be treated as customer representatives. That is, associated persons of a member cannot avoid the application of the firm's business entertainment policies by claiming that business entertainment provided to a person who is both a natural person customer and a customer representative was provided to that individual solely in his or her "personal," rather than business, capacity. A firm's written policies and procedures should treat all entertainment expenses provided to such persons as business entertainment subject to IM-3060, or develop specific policies and procedures for monitoring entertainment provided to such persons in a "personal" capacity to ensure that "personal" entertainment is not a pretext for impermissible business entertainment under IM-3060.

provide business entertainment to customer representatives of institutional customers. Members also would be permitted to institute additional procedures regarding business entertainment provided by associated persons of the member who are in business units where abusive business entertainment practices could be a higher risk.

Commenters also suggested that the definition of "customer representative" be revised so that only those customer representatives with decision-making authority regarding a customer's account are included in the definition.[9] Other commenters suggested that the proposed rule change only apply to certain types of associated persons of the member who provide business entertainment to customer representatives (e.g., those working in certain areas of a member firm such as investment banking, trading, or research).[10] Although these comments approach the issue from different perspectives, they are essentially seeking the same goal: to restrict the application of the proposed rule change to those business relationships that present the highest risk of abuse. Commenters suggesting changes to the definition of "customer representative" thus seek to limit the scope of the proposed rule by narrowing the range of recipients of business entertainment to which the proposed rule applies while other commenters seek to limit the scope of the proposed rule by narrowing the range of individuals providing business entertainment who are subject to the policies and procedures required by the proposed rule.

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9 See Commonwealth Letter; FSI Letter; Type A Letter.

10 See SIFMA Letter; NAIBD Letter.

Although FINRA does not agree with either approach suggested by the commenters, the proposed rule language has been amended in a different way to address the commenters' overriding concern regarding the reach of the proposed rule.[11]

FINRA does not believe the definition of "customer representative" should be restricted to only those individuals with decision-making authority over a customer's investment activity because other individuals who may lack the "authority" may nonetheless have influence over those decisions even if they lack the authority to make the final decision. Moreover, revising the definition in this manner ignores the situation where business entertainment is provided to a customer representative of a prospective, rather than existing, customer.

FINRA also does not believe that applying the proposed rule to persons engaged in certain types of activities or employees of certain departments is appropriate because it inappropriately narrows the scope of the rule. Business entertainment abuses are no less egregious simply because an individual works in one business unit rather than another.

To address the underlying concern raised by these commenters, rather than limiting the definition of "customer" or "customer representative," FINRA has revised the definition of "business entertainment" to include only those activities or events that

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[11] FINRA reiterates, again, that the proposed rule does not apply to firms that do not engage in any form of business entertainment. In Amendment No. 1, FINRA included statements to this effect in the rule filing and also added a sentence to the proposed rule that states: "This interpretation does not apply to any member that does not engage in business entertainment." Notwithstanding these statements, one commenter nonetheless stated that the proposed rule "should provide clear guidance that member firms who do not engage in business entertainment are not required to adopt the procedures contemplated by IM-3060." See FSI Letter. FINRA believes that it has already provided as much clarity regarding this issue as possible.

are "regarding an existing or prospective customer relationship." This language will permit firms to take into account the types of factors raised by the commenters (such as the identity of the recipient and the business unit in which the provider of the business entertainment works) in determining whether an activity or event is "business entertainment" without introducing into the rule language itself artificial distinctions. Thus, for example, if the compliance director of Firm A takes the compliance director of Firm B, who happens to be a "customer" of Firm A, out to lunch, it is less likely that this would fall within the amended definition of "business entertainment" because the meal is unlikely to be "regarding an existing or prospective customer relationship."

As noted in Amendment No. 1 to SR-NASD-2006-044, the definition of "customer representative" excluded certain family members from the definition to address those situations where a family member has power-of-attorney or similar authority over another family member's account. The proposed rule change defined a "family member" as a person's "parents, mother-in-law or father-in-law, spouse, brother or sister, bother-in-law or sister-in law, son-in-law or daughter-in-law, and children." Commenters suggested that the proposed definition of "family member" be broadened to include more distant relatives outside of the immediate family.[12] FINRA agrees with the commenters that expanding the definition of "family member" to include grandparents, grandchildren, aunts and uncles, cousins, and nieces and nephews is appropriate because these situations are also unlikely to present the conflict of interests the proposed rule seeks to address. The rule language has been amended to reflect these comments.

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[12] See SIFMA Letter; NAIBD Letter.

Response to Comments Concerning Post-Event Review of Business Entertainment

Numerous commenters requested that FINRA reevaluate its position that post-event review of business entertainment expenses that exceed a firm's threshold is not appropriate. As noted in Amendment No. 1, after the publication of NASD Notice to Members 06-06 in January 2006, one commenter suggested that post-event approval be permitted in limited circumstances. Amendment No. 1 stated that "NASD does not believe that a member's policies and procedures should allow for post-event approval because there does not appear to be an effective means of rescinding business entertainment that has already been provided." Many commenters have asked FINRA to reconsider that position.[13] One commenter expressed its view that post-event approval of business entertainment that unexpectedly exceeds the firm's threshold "does not differ materially from a situation where exigent circumstances arise preventing an associated person of the firm from attending a business entertainment event."[14] FINRA believes that the two situations are materially different and continues to believe that post-event review should not be permitted as a matter of course.

Paragraph (b)(5)(A) of proposed IM-3060 codifies FINRA's longstanding position that, if an associated person of a member does not accompany an individual to an event, the expenses associated with that event are deemed to be a gift under NASD Rule 3060. Paragraph (b)(5)(B) provides that, in those situations where "exigent circumstances make it impractical for an associated person of the member to attend," the

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13 See ABASA Letter; BofA Letter; ICI Letter; SIFMA Letter; T. Rowe Price Letter.

14 T. Rowe Price Letter.

expenses will not be considered a gift provided the exigent circumstances are "clearly and thoroughly documented" and subject to appropriate approval. The approval can be done promptly after the event only if "prior approval cannot reasonably be obtained." Thus, the current exigent circumstances exception provided in paragraph (b)(5)(B) provides relief from a violation of NASD Rule 3060 and potential FINRA enforcement proceedings.

In contrast, a business entertainment event that unexpectedly exceeds the firm's threshold is not an exigent circumstance. It is an eventuality that can be contemplated in the firm's policies and procedures. For example, firms may set limits as to the amount by which a threshold may be exceeded, the reporting that would follow in such instances, and the possibility of firm discipline for exceeding thresholds. Thus, although an associated person of the member may be subject to discipline by his or her firm for exceeding its internal requirements, there is not necessarily a violation of FINRA rules if the firm's policies and procedures are reasonably in accord with the purposes of the proposed rule and are adhered to by the firm and its supervisors.

FINRA continues to believe that a firm's policies and procedures may not permit post-event approval and that associated persons of the member who believe their firm's threshold may be exceeded should seek permission in advance to exceed the firm's threshold by a certain amount; it is the preferable practice for a firm to set a higher threshold in advance of a particular event of business entertainment, where such threshold remains in accordance with the requirements of the rule and reasonable determinations of appropriate levels of entertainment, rather than providing blanket permission to exceed the threshold.

Response to Comments Concerning the $7,500 Partial Exemption

Although most commenters that addressed the $7,500 exemption from portions of the proposed rule supported the proposal, two commenters stated that the $7,500 ceiling was too low because, for larger firms, the amount per registered person would be very small.[15] One commenter provided the following example: "a small IBD firm with 150 financial advisors would be subject to the Proposal's requirement if each advisor entertained a single customer representative a year with a $50 dinner."[16] The commenter went on to note that "[b]usiness entertaining of this nature could not be 'reasonably judged to have the likely effect of causing such customer representative to act in a manner that is inconsistent with the best interests of the customer.'"

FINRA agrees that a $50 dinner once a year is unlikely to cause such behavior; however, the amount per advisor used in the commenter's example misses the point. The partial exemption was intended to exempt firms that do very limited business entertainment from certain requirements of the rule. FINRA believes that employing a formula that takes into account the number of representatives or employees at a firm, as one commenter suggested, is a flawed approach. Under the example provided by one commenter, "a broker-dealer with 10 salespersons who collectively spend $74,999 in total business entertainment annually should be exempt from the record-keeping requirements."[17] Although, on a per-salesperson basis, this approach may have surface appeal, if, for example, only two of those salespersons actually engage in business

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15 See Commonwealth Letter; FSI Letter.

16 FSI Letter.

17 See 1st Global Letter.

entertainment, each of the individuals would have a business entertainment budget of $37,500. Moreover, under this analysis, a firm with 100 salespersons would be exempt from the recordkeeping requirements of the proposed rule if its business entertainment budget was lower than $750,000. Such a formula quickly expands the partial exemption beyond its intent: small firms that do minimal business entertainment.

As noted above, FINRA has amended the proposed rule change so that firms that do not provide business entertainment to customer representatives of institutional customers are not required to comply with all aspects of the proposed rule, including the recordkeeping provision.[18] In addition, paragraphs (c)(1) and (d) of the proposed rule apply only to business entertainment provided to customer representatives of institutional customers.

Response to Comments Concerning Recordkeeping

The Commission received several comment letters regarding the $50 exception from the recordkeeping requirement, including some commenters who suggested higher thresholds, such as $100 or $250. Other commenters requested guidance on certain aspects of the proposed rule's recordkeeping requirements.

FINRA has chosen to remove the $50 exception and instead let firms establish as part of their written policies and supervisory procedures the de minimis business expenses that will not be aggregated for purposes of the firm's business entertainment policies. As the comments revealed, the application of an across-the-board $50 exception conflicted with the principles-based approach of the proposed rule change. Moreover, in

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[18] Although the partial exemption includes an exemption from paragraph (d) of the proposed rule, firms should be aware that other recordkeeping rules may impose recordkeeping obligations with respect to these documents.

some cases, compliance with the $50 limit was impractical, as in the situation where two or more associated persons of a member firm separately, but unknowingly, entertained the same customer representative on the same day.

Rather than establish a $50 per day limit, FINRA will expect firms as part of their written policies and supervisory procedures to establish recordkeeping systems for monitoring business entertainment expenses. Such recordkeeping systems should be robust and designed to capture the necessary information for the firm to review for compliance with its policies and procedures. Moreover, each member's policies and procedures must include provisions reasonably designed to prevent associated persons of the member from circumventing the recordkeeping requirements in contravention of the spirit and purpose of the proposed rule change.

Response to Comments Regarding the Provision of Information to Customers

Paragraph (d)(2) of the proposed rule provides that a member's written policies and procedures must "require that, upon an institutional customer's written request, the member will promptly make available to the institutional customer any business entertainment records regarding business entertainment provided to customer representatives of that institutional customer." One commenter suggested deleting the paragraph because customers can already request this information,[19] and two other commenters requested confirmation that firms have the ability to determine the form, frequency, and scope of information supplied to customers.[20] After further considering this issue, FINRA believes that firms must provide this information to customers in a

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19 See T. Rowe Price Letter.

20 See SIFMA Letter; ABASA Letter.

timely and reasonable fashion and should not be permitted to place limitations on a customer's ability to request this information in their policies and procedures. Of course, as part of the firm's relationship with a particular customer, the firm and the customer may agree on such things as individuals with the customer who can request information, the form any such information will take, and other specific details concerning the request and provision of information. Moreover, firms are also able to eliminate business entertainment of customer representatives if the customer's requests become too burdensome.

Response to Comments Concerning Training and Education

Paragraph (c)(2)(B) of the proposed rule "require[s] appropriate training and education for all personnel who supervise, administer, or are subject to the written policies and procedures."[21] Commenters requested that FINRA clarify those persons covered by the paragraph, specifically, those who "administer" the written policies and procedures.[22] This paragraph is intended to ensure that personnel responsible for any aspect of a firm's business entertainment policies and procedures are familiar with the rule's requirements and objectives. The level of training and education required under a firm's policies and procedures would differ depending upon the functions the individual performs. Although individuals whose responsibilities are solely clerical or ministerial need not be provided formal education or training, they should nonetheless be aware of the requirements of the rule and the purpose of those requirements. Of course, registered

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21 FINRA has also deleted former paragraph (c)(1)(E) from the rule language proposed in Amendment No. 1 because it was duplicative of the requirements in paragraph (c)(2)(B).

22 See ICI Letter; T. Rowe Price Letter.

persons supervising compliance with the rule or persons subject to the rule would need increased education and training. It is the responsibility of each firm to determine the appropriate level of training and education with respect to particular individuals.

Response to Comments Regarding Implications of the Proposed Rule

Some commenters took issue with broader implications of the proposed rule change. One commenter expressed concern with the fact that the proposed rule is intended to supersede previous guidance concerning business entertainment.[23] The commenter suggested that by replacing the standard currently in effect with required policies and procedures, "the nature of the business entertainment itself will no longer be the point of scrutiny but rather the effect the entertainment has on its recipient becomes the point of scrutiny." FINRA disagrees with this conclusion and believes that the new formulation will reduce the incidence of abusive business entertainment practices.

Under the former interpretation, business entertainment was permitted unless it was either so frequent or so extensive as to raise any question of propriety. Under the proposed rule change, firms that engage in business entertainment are required to adopt written policies and procedures reasonably designed to prevent this type of abuse and supervise individuals to ensure compliance with those policies and procedures. In fact, paragraph (c)(2)(A) requires that the policies and procedures "define forms of business entertainment that are appropriate and inappropriate using quantitative and/or qualitative standards that address the nature and frequency of the entertainment provided." (emphasis added) Thus, the proposed rule change codifies the notion that the nature and frequency of business entertainment is of utmost concern, and firms are required to

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[23] See Pace Letter.

address both issues in their written policies and procedures. Moreover, every person associated with a member who provides business entertainment to a customer representative is subject to the general requirements of paragraph (a) of the proposed rule notwithstanding the member's policies and procedures.

One commenter sought clarification "regarding the relative responsibilities of the firm and the customer [whose representative] is being entertained."[24] The commenter requested that FINRA "affirm that broker-dealers would not assume any additional obligations to customers, such as evaluating and/or monitoring the activities of a customer's employees or representatives."

The proposed rule neither speaks to monitoring the activities of the customer representative nor is it implicitly intended as an obligation. In Amendment No. 1, FINRA noted that "customers whose representatives receive business entertainment have the responsibility to ensure that their representatives do not engage in improper conduct." The proposed rule change creates express obligations upon members that engage in business entertainment to design appropriate written policies and procedures reasonably designed to prevent its associated persons from providing business entertainment that is intended to cause, or could reasonably be judged to be likely to cause, a customer representative to act in a manner inconsistent with the customer's best interests. Consequently, FINRA does not believe that the language of the proposed rule change requires amendment to address this point as the current language does not in fact raise the concerns expressed by the commenter.

New Effective Date

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[24] See SIFMA Letter.

As noted in Item 2 of this filing, the effective date of the proposed rule change will be one year following Commission approval.[25] FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[26] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change clarifies existing obligations of members with respect to the provision of business entertainment and will help prevent conduct by associated persons of a member that could undermine the performance of an employee's duty to the member's customer.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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25 The original rule filing and Amendment No. 1 included an effective date of six months following the Commission's approval. Numerous commenters stated that six months was insufficient and that nine months or one year following Commission approval were more appropriate timeframes. See, e.g., ABASA Letter; BofA Letter; ICI Letter; Lehman Letter; SIFMA Letter.

26 15 U.S.C. 78o–3(b)(6).

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Commission published the proposed rule change in the Federal Register on May 22, 2007.[27] The comment period closed on June 12, 2007. The Commission received 30 comment letters in response to the Federal Register publication of the proposal. The comments are summarized above.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[28]

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 4. Exhibit 4 shows the full text of the rule change marking changes from Amendment No. 1 to the originally filed proposed rule change, with the original language changes shown as if adopted, and the new language marked to show additions and deletions.

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27 See 72 FR 28743 (May 22, 2007).

28 15 U.S.C. 78s(b)(2).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2006-044)

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing Amendment No. 3 to Proposed Rule Change Relating to Interpretive Material to NASD Rule 3060 to Require Members to Adopt Policies and Procedures Addressing Business Entertainment

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on April 11, 2006, Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission") and amended on April 17, 2007, and May 1, 2007,[3] the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt IM-3060 to require members that engage in business entertainment to adopt policies and procedures addressing business entertainment. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Amendment No. 1 to SR-NASD-2006-044 replaced and superseded the original rule filing filed on April 11, 2006, except Exhibits 2a and 2b. Amendment No. 2 to SR-NASD-2006-044 provided an Exhibit 4 that showed the changes in proposed rule text between the original filing and Amendment No. 1.

* * * * *

IM-3060. Business Entertainment

The NASD Board of Governors is issuing this interpretation concerning the obligations of a member in connection with any business entertainment of a customer representative. This interpretation does not apply to any non-cash compensation that falls within Rule 2820(g) or Rule 2830(l) (i.e., entertainment provided by offerors to associated persons of a member in connection with the sale and distribution of variable contracts or investment company securities). This interpretation does not apply to any member that does not engage in business entertainment. For any member that engages in business entertainment, this interpretation applies only with respect to business entertainment provided to customer representatives. This interpretation supersedes any prior interpretive letters or statements of NASD staff regarding business entertainment under Rule 3060.

(a) General Requirements

No member or person associated with a member shall, directly or indirectly, provide any business entertainment to a customer representative pursuant to the establishment of, or during the course of, a business relationship with any customer that is intended or designed to cause, or would be reasonably judged to have the likely effect of causing, such customer representative to act in a manner that is inconsistent with:

(1) the best interests of the customer; or

(2) the best interests of any person to whom the customer owes a fiduciary duty.

(b) Definitions

For purposes of this interpretation, the following definitions shall apply:

(1) The term "customer" means:

(A) a person that maintains a business relationship with a member via the maintenance of an account, through the conduct of investment banking, or pursuant to other securities-related activity; or

(B) a person whose customer representative receives business entertainment for the purpose of encouraging such person to establish a business relationship with the member by opening an account with the member or by conducting investment banking or other securities-related activity with the member.

(2) The term "customer representative" means a person who is an employee, officer, director, or agent of a customer, unless such person is a family member of the customer.

(3) The term "family member" means a person's parents, grandparents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, children, grandchildren, cousin, aunt or uncle, and niece or nephew.

(4) The term "institutional customer" means a customer that meets the definition of "institutional account" in Rule 3110(c)(4).

(5) (A) The term "business entertainment" means any social event, hospitality event, sporting event, entertainment event, meal, leisure activity, or event of like nature or purpose regarding an existing or

prospective customer relationship, including business entertainment offered in connection with a charitable event, educational event or business conference, as well as any transportation or lodging related to such activity or event, in which an appropriate associated person of a member accompanies a customer representative.

(B) If a customer representative is not accompanied by an appropriate associated person of the member, any expenses associated with the business entertainment will be considered a gift under Rule 3060 unless exigent circumstances make it impractical for an associated person of the member to attend. All instances where such exigent circumstances are invoked must be clearly and thoroughly documented and be subject to the prior written approval of a designated supervisory person or, in very limited circumstances where such prior approval cannot reasonably be obtained, to a prompt post-event review to be conducted and documented by such supervisory person.

(C) Anything of value given or provided to a customer representative that does not fall within the definition of "business entertainment" is a gift under Rule 3060.

(D) In valuing business entertainment expenses pursuant to this interpretation, a member's written policies and procedures must specify the methodology to be used by the member to calculate the value of business entertainment. In general, business entertainment expenses should be valued at the higher of face value or cost to the member.

(c) Written Policies and Procedures

(1) Each member must have written policies and supervisory procedures that, with respect to business entertainment provided to customer representatives of institutional customers:

(A) define forms of business entertainment that are appropriate and inappropriate using quantitative and/or qualitative standards that address the nature and frequency of the entertainment provided, as well as the type and class of any accommodations or transportation provided in connection with such business entertainment; and

(B) impose either specific dollar limits on business entertainment or require advance written supervisory approval beyond specified dollar thresholds.

(2) Each member must have written policies and supervisory procedures that, with respect to business entertainment provided to customer representatives of all customers:

(A) are designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived to be intended as, an improper quid pro quo or that could otherwise give rise to a potential conflict of interest or undermine the performance of a customer representative's duty to a customer or any person to whom the customer owes a fiduciary duty;

(B) require appropriate training and education for all personnel who supervise, administer, or are subject to the written policies and procedures; and

(C) make clear that anything of value given or otherwise provided to a customer representative that does not fall within the definition of "business entertainment" is a gift under Rule 3060.

(3) A member's written policies and procedures may distinguish, and set specifically tailored standards for, business entertainment in connection with events that are deemed to be primarily educational, charitable, or philanthropic in nature, provided that such standards comply with the requirements of this interpretation and are explicitly addressed in the written policies and procedures.

(d) Recordkeeping

(1) Each member's written policies and procedures must require the maintenance of detailed records of business entertainment expenses provided to any customer representative of an institutional customer and must include provisions reasonably designed to prevent associated persons of the member from circumventing the recordkeeping requirements in contravention of the spirit and purpose of this interpretation.

(2) Each member's written policies and procedures must require that, upon an institutional customer's written request, the member will promptly make available to the institutional customer any business entertainment records regarding business entertainment provided to customer representatives of that institutional customer.

(e) Exemption for Members with Business Entertainment Expenses Below $7,500

A member whose business entertainment expenses in the course of its fiscal year are below $7,500 shall be subject only to paragraphs (a), (b), and (c)(2) of this interpretation. Each member that relies on this exemption must evidence that its business entertainment expenses are below the $7,500 threshold.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

This Amendment No. 3 to SR-NASD-2006-044 responds to the comments received by the Commission in response to the notice of proposed rulemaking published in the Federal Register on May 22, 2007 regarding proposed new IM-3060. This Amendment No. 3 also makes several amendments to the text of the proposed rule change in response to those comments and establishes a new effective date for the proposed rule change. FINRA (then known as NASD) proposed IM-3060 after receiving member requests for more guidance on the rules concerning gifts and business

entertainment following numerous press reports of enforcement actions regarding gifts and gratuities. In response to these requests, FINRA is proposing to adopt interpretive material to NASD Rule 3060 that outlines the policies and procedures that a member must adopt in connection with its business entertainment practices. As proposed, IM-3060 would only apply to member firms that engage in business entertainment.

The Commission received 29 comment letters in response to the proposed rulemaking.[4] While many of the commenters expressed overall support for the proposed rule change, all of the commenters expressed concerns regarding particular provisions of the proposed rule change. FINRA staff's response to the comment letters is provided below.

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[4] Letter from Royal Alliance Associates dated June 22, 2007 ("Royal Alliance Letter"); Letter from Lehman Brothers, Inc. dated June 15, 2007 ("Lehman Letter"); Letter from ABA Securities Association dated June 12, 2007 ("ABASA Letter"); Letter from Commonwealth Financial Network dated June 12, 2007 ("Commonwealth Letter"); Letter from Financial Services Institute dated June 12, 2007 ("FSI Letter"); Letter from Great American Advisors dated June 12, 2007 ("GAA Letter"); Letter from Pace Investor Rights Project dated June 12, 2007 ("Pace Letter"); Letter from 1st Global Capital Corp. dated June 11, 2007 ("1st Global Letter"); Letter from Bank of America Corporation dated June 11, 2007 ("BofA Letter"); Letter from Investment Company Institute dated June 11, 2007 ("ICI Letter"); Letter from National Association of Independent Broker-Dealers dated June 11, 2007 ("NAIBD Letter"); Letter from Securities Industry and Financial Markets Association dated June 11, 2007 ("SIFMA Letter"); Letter from T. Rowe Price Investment Services, Inc. dated June 8, 2007 ("T. Rowe Price Letter"); Letter from Coastal Securities dated June 1, 2007; Letter from Judith Schapiro dated May 17, 2007.

In addition to receiving the 15 letters cited above, the Commission received 14 copies of a form comment letter referred to herein as the "Type A Letter." In addition, the Commission received a comment letter from the Bond Market Association ("BMA") dated July 13, 2006, which predates the filing of Amendment No. 1 and Amendment No. 2. Because the BMA merged with the Securities Industry Association to form the Securities Industry and Financial Markets Association ("SIFMA"), and SIFMA filed a comment letter following the publication of the proposed rule filing in the Federal Register, this Amendment No. 3 does not address the issues raised in the BMA letter.

Response to Comments Concerning Definitions

Many commenters expressed concern over the breadth of the proposed rule and, in particular, the broad definitions of the terms "customer" and "customer representative." For example, several commenters suggested that the term "customer" be limited to institutional accounts because the abuses that the proposed rule change seeks to address occur more often when customer representatives of institutional customers are involved, and firms are substantially less likely to engage in abusive business entertainment practices with respect to small accounts.[5] FINRA agrees with those commenters that larger accounts present a greater risk of abusive business entertainment practices than the risks posed by smaller accounts. Although FINRA believes that portions of the proposed rule change should apply to all firms that engage in business entertainment and should apply to all customers, FINRA believes it is appropriate to limit the application of certain provisions of the proposed rule to business entertainment provided to customer representatives of customers, or potential customers, that meet the definition of "institutional account" in NASD Rule 3110(c)(4).[6] Thus, under the amended proposed rule, paragraphs (c)(1) and (d) apply only to business entertainment provided to customer representatives of institutional customers.

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5 See 1st Global Letter; Commonwealth Letter; FSI Letter; GAA Letter; Royal Alliance Letter; Type A Letter.

6 NASD Rule 3110(c)(4) defines an institutional account as "(A) a bank, savings and loan association, insurance company, or registered investment company; (B) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (C) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million."

One commenter suggested that the definition of "customer" was so broad that members could not make risk-based determinations and choose the customers to which the business entertainment policies and procedures should apply.[7] FINRA does not believe that certain customers should be wholly excluded from a member's business entertainment policies and procedures. FINRA believes that the current language of the proposed rule already provides sufficiently flexibility to allow members to design their policies and procedures such that business entertainment provided to certain customers is subject to more rigorous oversight than business entertainment provided to lower-risk customers.[8] In addition, as noted above, the proposed rule has been amended so that members are required to comply with paragraphs (c)(1) and (d) only to the extent they provide business entertainment to customer representatives of institutional customers. Members also would be permitted to institute additional procedures regarding business

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7 See Lehman Letter. In a similar vein, the commenter also suggested that supervisory pre-approval be allowed to "kick in" once a cumulative threshold of spending on a particular customer is reached. FINRA believes that, under the current language of the proposed rule, such a policy would already be permitted under paragraph (c)(1)(C).

8 FINRA has also been asked about natural persons who are both customers and customer representatives. As discussed in footnote 5 of NASD Notice to Members 06–06, and as noted in Amendment No. 1, natural persons who are both natural person customers and customer representatives should be treated as customer representatives. That is, associated persons of a member cannot avoid the application of the firm's business entertainment policies by claiming that business entertainment provided to a person who is both a natural person customer and a customer representative was provided to that individual solely in his or her "personal," rather than business, capacity. A firm's written policies and procedures should treat all entertainment expenses provided to such persons as business entertainment subject to IM-3060, or develop specific policies and procedures for monitoring entertainment provided to such persons in a "personal" capacity to ensure that "personal" entertainment is not a pretext for impermissible business entertainment under IM-3060.

entertainment provided by associated persons of the member who are in business units where abusive business entertainment practices could be a higher risk.

Commenters also suggested that the definition of "customer representative" be revised so that only those customer representatives with decision-making authority regarding a customer's account are included in the definition.[9] Other commenters suggested that the proposed rule change only apply to certain types of associated persons of the member who provide business entertainment to customer representatives (e.g., those working in certain areas of a member firm such as investment banking, trading, or research).[10] Although these comments approach the issue from different perspectives, they are essentially seeking the same goal: to restrict the application of the proposed rule change to those business relationships that present the highest risk of abuse. Commenters suggesting changes to the definition of "customer representative" thus seek to limit the scope of the proposed rule by narrowing the range of recipients of business entertainment to which the proposed rule applies while other commenters seek to limit the scope of the proposed rule by narrowing the range of individuals providing business entertainment who are subject to the policies and procedures required by the proposed rule.

Although FINRA does not agree with either approach suggested by the commenters, the proposed rule language has been amended in a different way to address the commenters' overriding concern regarding the reach of the proposed rule.[11]

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9 See Commonwealth Letter; FSI Letter; Type A Letter.

10 See SIFMA Letter; NAIBD Letter.

11 FINRA reiterates, again, that the proposed rule does not apply to firms that do not engage in any form of business entertainment. In Amendment No. 1, FINRA included statements to this effect in the rule filing and also added a sentence to the proposed rule that states: "This interpretation does not apply to any member that

FINRA does not believe the definition of "customer representative" should be restricted to only those individuals with decision-making authority over a customer's investment activity because other individuals who may lack the "authority" may nonetheless have influence over those decisions even if they lack the authority to make the final decision. Moreover, revising the definition in this manner ignores the situation where business entertainment is provided to a customer representative of a prospective, rather than existing, customer.

FINRA also does not believe that applying the proposed rule to persons engaged in certain types of activities or employees of certain departments is appropriate because it inappropriately narrows the scope of the rule. Business entertainment abuses are no less egregious simply because an individual works in one business unit rather than another.

To address the underlying concern raised by these commenters, rather than limiting the definition of "customer" or "customer representative," FINRA has revised the definition of "business entertainment" to include only those activities or events that are "regarding an existing or prospective customer relationship." This language will permit firms to take into account the types of factors raised by the commenters (such as the identity of the recipient and the business unit in which the provider of the business entertainment works) in determining whether an activity or event is "business entertainment" without introducing into the rule language itself artificial distinctions. Thus, for example, if the compliance director of Firm A takes the compliance director of

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does not engage in business entertainment." Notwithstanding these statements, one commenter nonetheless stated that the proposed rule "should provide clear guidance that member firms who do not engage in business entertainment are not required to adopt the procedures contemplated by IM-3060." See FSI Letter. FINRA believes that it has already provided as much clarity regarding this issue as possible.

Firm B, who happens to be a "customer" of Firm A, out to lunch, it is less likely that this would fall within the amended definition of "business entertainment" because the meal is unlikely to be "regarding an existing or prospective customer relationship."

As noted in Amendment No. 1 to SR-NASD-2006-044, the definition of "customer representative" excluded certain family members from the definition to address those situations where a family member has power-of-attorney or similar authority over another family member's account. The proposed rule change defined a "family member" as a person's "parents, mother-in-law or father-in-law, spouse, brother or sister, bother-in-law or sister-in law, son-in-law or daughter-in-law, and children." Commenters suggested that the proposed definition of "family member" be broadened to include more distant relatives outside of the immediate family.[12] FINRA agrees with the commenters that expanding the definition of "family member" to include grandparents, grandchildren, aunts and uncles, cousins, and nieces and nephews is appropriate because these situations are also unlikely to present the conflict of interests the proposed rule seeks to address. The rule language has been amended to reflect these comments.

Response to Comments Concerning Post-Event Review of Business Entertainment

Numerous commenters requested that FINRA reevaluate its position that post-event review of business entertainment expenses that exceed a firm's threshold is not appropriate. As noted in Amendment No. 1, after the publication of NASD Notice to Members 06-06 in January 2006, one commenter suggested that post-event approval be permitted in limited circumstances. Amendment No. 1 stated that "NASD does not believe that a member's policies and procedures should allow for post-event approval

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12 See SIFMA Letter; NAIBD Letter.

because there does not appear to be an effective means of rescinding business entertainment that has already been provided." Many commenters have asked FINRA to reconsider that position.[13] One commenter expressed its view that post-event approval of business entertainment that unexpectedly exceeds the firm's threshold "does not differ materially from a situation where exigent circumstances arise preventing an associated person of the firm from attending a business entertainment event."[14] FINRA believes that the two situations are materially different and continues to believe that post-event review should not be permitted as a matter of course.

Paragraph (b)(5)(A) of proposed IM-3060 codifies FINRA's longstanding position that, if an associated person of a member does not accompany an individual to an event, the expenses associated with that event are deemed to be a gift under NASD Rule 3060. Paragraph (b)(5)(B) provides that, in those situations where "exigent circumstances make it impractical for an associated person of the member to attend," the expenses will not be considered a gift provided the exigent circumstances are "clearly and thoroughly documented" and subject to appropriate approval. The approval can be done promptly after the event only if "prior approval cannot reasonably be obtained." Thus, the current exigent circumstances exception provided in paragraph (b)(5)(B) provides relief from a violation of NASD Rule 3060 and potential FINRA enforcement proceedings.

In contrast, a business entertainment event that unexpectedly exceeds the firm's threshold is not an exigent circumstance. It is an eventuality that can be contemplated in

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13 See ABASA Letter; BofA Letter; ICI Letter; SIFMA Letter; T. Rowe Price Letter.

14 T. Rowe Price Letter.

the firm's policies and procedures. For example, firms may set limits as to the amount by which a threshold may be exceeded, the reporting that would follow in such instances, and the possibility of firm discipline for exceeding thresholds. Thus, although an associated person of the member may be subject to discipline by his or her firm for exceeding its internal requirements, there is not necessarily a violation of FINRA rules if the firm's policies and procedures are reasonably in accord with the purposes of the proposed rule and are adhered to by the firm and its supervisors.

FINRA continues to believe that a firm's policies and procedures may not permit post-event approval and that associated persons of the member who believe their firm's threshold may be exceeded should seek permission in advance to exceed the firm's threshold by a certain amount; it is the preferable practice for a firm to set a higher threshold in advance of a particular event of business entertainment, where such threshold remains in accordance with the requirements of the rule and reasonable determinations of appropriate levels of entertainment, rather than providing blanket permission to exceed the threshold.

Response to Comments Concerning the $7,500 Partial Exemption

Although most commenters that addressed the $7,500 exemption from portions of the proposed rule supported the proposal, two commenters stated that the $7,500 ceiling was too low because, for larger firms, the amount per registered person would be very small.[15] One commenter provided the following example: "a small IBD firm with 150 financial advisors would be subject to the Proposal's requirement if each advisor

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15 See Commonwealth Letter; FSI Letter.

entertained a single customer representative a year with a $50 dinner."[16] The commenter went on to note that "[b]usiness entertaining of this nature could not be 'reasonably judged to have the likely effect of causing such customer representative to act in a manner that is inconsistent with the best interests of the customer.'"

FINRA agrees that a $50 dinner once a year is unlikely to cause such behavior; however, the amount per advisor used in the commenter's example misses the point. The partial exemption was intended to exempt firms that do very limited business entertainment from certain requirements of the rule. FINRA believes that employing a formula that takes into account the number of representatives or employees at a firm, as one commenter suggested, is a flawed approach. Under the example provided by one commenter, "a broker-dealer with 10 salespersons who collectively spend $74,999 in total business entertainment annually should be exempt from the record-keeping requirements."[17] Although, on a per-salesperson basis, this approach may have surface appeal, if, for example, only two of those salespersons actually engage in business entertainment, each of the individuals would have a business entertainment budget of $37,500. Moreover, under this analysis, a firm with 100 salespersons would be exempt from the recordkeeping requirements of the proposed rule if its business entertainment budget was lower than $750,000. Such a formula quickly expands the partial exemption beyond its intent: small firms that do minimal business entertainment.

As noted above, FINRA has amended the proposed rule change so that firms that do not provide business entertainment to customer representatives of institutional

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16 FSI Letter.

17 See 1st Global Letter.

customers are not required to comply with all aspects of the proposed rule, including the recordkeeping provision.[18] In addition, paragraphs (c)(1) and (d) of the proposed rule apply only to business entertainment provided to customer representatives of institutional customers.

Response to Comments Concerning Recordkeeping

The Commission received several comment letters regarding the $50 exception from the recordkeeping requirement, including some commenters who suggested higher thresholds, such as $100 or $250. Other commenters requested guidance on certain aspects of the proposed rule's recordkeeping requirements.

FINRA has chosen to remove the $50 exception and instead let firms establish as part of their written policies and supervisory procedures the de minimis business expenses that will not be aggregated for purposes of the firm's business entertainment policies. As the comments revealed, the application of an across-the-board $50 exception conflicted with the principles-based approach of the proposed rule change. Moreover, in some cases, compliance with the $50 limit was impractical, as in the situation where two or more associated persons of a member firm separately, but unknowingly, entertained the same customer representative on the same day.

Rather than establish a $50 per day limit, FINRA will expect firms as part of their written policies and supervisory procedures to establish recordkeeping systems for monitoring business entertainment expenses. Such recordkeeping systems should be robust and designed to capture the necessary information for the firm to review for

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[18] Although the partial exemption includes an exemption from paragraph (d) of the proposed rule, firms should be aware that other recordkeeping rules may impose recordkeeping obligations with respect to these documents.

compliance with its policies and procedures. Moreover, each member's policies and procedures must include provisions reasonably designed to prevent associated persons of the member from circumventing the recordkeeping requirements in contravention of the spirit and purpose of the proposed rule change.

Response to Comments Regarding the Provision of Information to Customers

Paragraph (d)(2) of the proposed rule provides that a member's written policies and procedures must "require that, upon an institutional customer's written request, the member will promptly make available to the institutional customer any business entertainment records regarding business entertainment provided to customer representatives of that institutional customer." One commenter suggested deleting the paragraph because customers can already request this information,[19] and two other commenters requested confirmation that firms have the ability to determine the form, frequency, and scope of information supplied to customers.[20] After further considering this issue, FINRA believes that firms must provide this information to customers in a timely and reasonable fashion and should not be permitted to place limitations on a customer's ability to request this information in their policies and procedures. Of course, as part of the firm's relationship with a particular customer, the firm and the customer may agree on such things as individuals with the customer who can request information, the form any such information will take, and other specific details concerning the request and provision of information. Moreover, firms are also able to eliminate business

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19 See T. Rowe Price Letter.

20 See SIFMA Letter; ABASA Letter.

entertainment of customer representatives if the customer's requests become too burdensome.

Response to Comments Concerning Training and Education

Paragraph (c)(2)(B) of the proposed rule "require[s] appropriate training and education for all personnel who supervise, administer, or are subject to the written policies and procedures."[21] Commenters requested that FINRA clarify those persons covered by the paragraph, specifically, those who "administer" the written policies and procedures.[22] This paragraph is intended to ensure that personnel responsible for any aspect of a firm's business entertainment policies and procedures are familiar with the rule's requirements and objectives. The level of training and education required under a firm's policies and procedures would differ depending upon the functions the individual performs. Although individuals whose responsibilities are solely clerical or ministerial need not be provided formal education or training, they should nonetheless be aware of the requirements of the rule and the purpose of those requirements. Of course, registered persons supervising compliance with the rule or persons subject to the rule would need increased education and training. It is the responsibility of each firm to determine the appropriate level of training and education with respect to particular individuals.

Response to Comments Regarding Implications of the Proposed Rule

Some commenters took issue with broader implications of the proposed rule change. One commenter expressed concern with the fact that the proposed rule is

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21 FINRA has also deleted former paragraph (c)(1)(E) from the rule language proposed in Amendment No. 1 because it was duplicative of the requirements in paragraph (c)(2)(B).

22 See ICI Letter; T. Rowe Price Letter.

intended to supersede previous guidance concerning business entertainment.[23] The commenter suggested that by replacing the standard currently in effect with required policies and procedures, "the nature of the business entertainment itself will no longer be the point of scrutiny but rather the effect the entertainment has on its recipient becomes the point of scrutiny." FINRA disagrees with this conclusion and believes that the new formulation will reduce the incidence of abusive business entertainment practices.

Under the former interpretation, business entertainment was permitted unless it was either so frequent or so extensive as to raise any question of propriety. Under the proposed rule change, firms that engage in business entertainment are required to adopt written policies and procedures reasonably designed to prevent this type of abuse and supervise individuals to ensure compliance with those policies and procedures. In fact, paragraph (c)(2)(A) requires that the policies and procedures "define forms of business entertainment that are appropriate and inappropriate using quantitative and/or qualitative standards that address the nature and frequency of the entertainment provided." (emphasis added) Thus, the proposed rule change codifies the notion that the nature and frequency of business entertainment is of utmost concern, and firms are required to address both issues in their written policies and procedures. Moreover, every person associated with a member who provides business entertainment to a customer representative is subject to the general requirements of paragraph (a) of the proposed rule notwithstanding the member's policies and procedures.

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23 See Pace Letter.

One commenter sought clarification "regarding the relative responsibilities of the firm and the customer [whose representative] is being entertained."[24] The commenter requested that FINRA "affirm that broker-dealers would not assume any additional obligations to customers, such as evaluating and/or monitoring the activities of a customer's employees or representatives."

The proposed rule neither speaks to monitoring the activities of the customer representative nor is it implicitly intended as an obligation. In Amendment No. 1, FINRA noted that "customers whose representatives receive business entertainment have the responsibility to ensure that their representatives do not engage in improper conduct." The proposed rule change creates express obligations upon members that engage in business entertainment to design appropriate written policies and procedures reasonably designed to prevent its associated persons from providing business entertainment that is intended to cause, or could reasonably be judged to be likely to cause, a customer representative to act in a manner inconsistent with the customer's best interests. Consequently, FINRA does not believe that the language of the proposed rule change requires amendment to address this point as the current language does not in fact raise the concerns expressed by the commenter.

New Effective Date

The effective date of the proposed rule change will be one year following Commission approval.[25] FINRA will announce the effective date of the proposed rule

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24 See SIFMA Letter.

25 The original rule filing and Amendment No. 1 included an effective date of six months following the Commission's approval. Numerous commenters stated that six months was insufficient and that nine months or one year following

change in a Regulatory Notice to be published no later than 60 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[26] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change clarifies existing obligations of members with respect to the provision of business entertainment and will help prevent conduct by associated persons of a member that could undermine the performance of an employee's duty to the member's customer.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Commission published the proposed rule change in the Federal Register on May 22, 2007.[27] The comment period closed on June 12, 2007. The Commission

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Commission approval were more appropriate timeframes. See, e.g., ABASA Letter; BofA Letter; ICI Letter; Lehman Letter; SIFMA Letter.

26 15 U.S.C. 78o–3(b)(6).

27 See 72 FR 28743 (May 22, 2007).

received 30 comment letters in response to the Federal Register publication of the proposal. The comments are summarized above.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved..

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2006-044 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-044. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of FINRA.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2006-044 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[28]

Nancy M. Morris

Secretary

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[28] 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Below is the text of the proposed rule change marking changes from Amendment No. 1 to the originally filed proposed rule change. The original language changes are shown as if adopted and the new language is marked to show additions. Proposed new language is underlined; proposed deletions are in brackets.

IM-3060. Business Entertainment

The NASD Board of Governors is issuing this interpretation concerning the obligations of a member in connection with any business entertainment of a customer representative. This interpretation does not apply to any non-cash compensation that falls within Rule 2820(g) or Rule 2830(l) (i.e., entertainment provided by offerors to associated persons of a member in connection with the sale and distribution of variable contracts or investment company securities). This interpretation does not apply to any member that does not engage in business entertainment. For any member that engages in business entertainment, this interpretation applies only with respect to business entertainment provided to customer representatives. This interpretation supersedes any prior interpretive letters or statements of NASD staff regarding business entertainment under Rule 3060.

(a) General Requirements

No member or person associated with a member shall, directly or indirectly, provide any business entertainment to a customer representative pursuant to the establishment of, or during the course of, a business relationship with any customer that is intended or designed to cause, or would be reasonably judged to have the likely effect of causing, such customer representative to act in a manner that is inconsistent with:

(1) the best interests of the customer; or

(2) the best interests of any person to whom the customer owes a

fiduciary duty.

(b) Definitions

For purposes of this interpretation, the following definitions shall apply:

(1) The term "customer" means:

(A) a person that maintains a business relationship with a member via the maintenance of an account, through the conduct of investment banking, or pursuant to other securities-related activity; or

(B) a person whose customer representative receives business entertainment for the purpose of encouraging such person to establish a business relationship with the member by opening an account with the member or by conducting investment banking or other securities-related activity with the member.

(2) The term "customer representative" means a person who is an employee, officer, director, or agent of a customer, unless such person is a family member of the customer.

(3) The term "family member" means a person's parents, grandparents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, [and] children, grandchildren, cousin, aunt or uncle, and niece or nephew.

(4) The term "institutional customer" means a customer that meets the definition of "institutional account" in Rule 3110(c)(4).

([4]5) (A) The term "business entertainment" means any social event, hospitality event, sporting event, entertainment event, meal, leisure

activity, or event of like nature or purpose regarding an existing or prospective customer relationship, including business entertainment offered in connection with a charitable event, educational event or business conference, as well as any transportation or lodging related to such activity or event, in which an appropriate associated person of a member accompanies a customer representative.

([A]B) If a customer representative is not accompanied by an appropriate associated person of the member, any expenses associated with the business entertainment will be considered a gift under Rule 3060 unless exigent circumstances make it impractical for an associated person of the member to attend. All instances where such exigent circumstances are invoked must be clearly and thoroughly documented and be subject to the prior written approval of a designated supervisory person or, in very limited circumstances where such prior approval cannot reasonably be obtained, to a prompt post-event review to be conducted and documented by such supervisory person.

([B]C) Anything of value given or provided to a customer representative that does not fall within the definition of "business entertainment" is a gift under Rule 3060.

([C]D) In valuing business entertainment expenses pursuant to this interpretation, a member's written policies and procedures must specify the methodology to be used by the member to calculate the value of business entertainment. In general, business entertainment expenses

should be valued at the higher of face value or cost to the member.

(c) Written Policies and Procedures

(1) Each member must have written policies and supervisory procedures that, with respect to business entertainment provided to customer representatives of institutional customers:

(A) define forms of business entertainment that are appropriate and inappropriate using quantitative and/or qualitative standards that address the nature and frequency of the entertainment provided, as well as the type and class of any accommodations or transportation provided in connection with such business entertainment; and

[(B) make clear that anything of value given or otherwise provided to a customer representative that does not fall within the definition of "business entertainment" is a gift under Rule 3060; and]

([C]B) impose either specific dollar limits on business entertainment or require advance written supervisory approval beyond specified dollar thresholds.[; and]

(2) Each member must have written policies and supervisory procedures that, with respect to business entertainment provided to customer representatives of all customers:

([D]A) are designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived to be intended as, an improper quid pro quo or that could otherwise give rise to a potential conflict of interest or undermine the performance of a customer

representative's duty to a customer or any person to whom the customer owes a fiduciary duty; [and]

[(E) establish standards to ensure that persons designated to supervise and administer the written policies and procedures are sufficiently qualified; and]

([F]B) require appropriate training and education for all personnel who supervise, administer, or are subject to the written policies and procedures; and[.]

(C) make clear that anything of value given or otherwise provided to a customer representative that does not fall within the definition of "business entertainment" is a gift under Rule 3060.

([2]3) A member's written policies and procedures may distinguish, and set specifically tailored standards for, business entertainment in connection with events that are deemed to be primarily educational, charitable, or philanthropic in nature, provided that such standards comply with the requirements of this interpretation and are explicitly addressed in the written policies and procedures.

(d) Recordkeeping

(1) Each member's written policies and procedures must require the maintenance of detailed records of business entertainment expenses provided to any customer representative of an institutional customer[. The member is not required to maintain records of:]

[(A) business entertainment when the total value of the business entertainment, including all expenses associated with the business

entertainment, does not exceed $50 per day; or]

[(B) additional expenses incurred in connection with otherwise recorded business entertainment that do not, in the aggregate, exceed $50 per day.]

[(2) Each member's written policies and procedures] and must include provisions reasonably designed to prevent associated persons of the member from circumventing the recordkeeping requirements in contravention of the spirit and purpose of this interpretation[(e.g., a pattern of providing a customer representative with business entertainment valued at $48)].

([3]2) Each member's written policies and procedures must require that, upon an institutional customer's written request, the member will promptly make available to the institutional customer any business entertainment records regarding business entertainment provided to customer representatives of that institutional customer.

(e) Exemption for Members with Business Entertainment Expenses Below $7,500

A member whose business entertainment expenses in the course of its fiscal year are below $7,500 shall be subject only to paragraphs (a), (b), and (c)(2)[(1)(D) and (E)] of this interpretation[, and shall be exempt from paragraphs (c) (other than (c)(1)(D) and (E) as noted above) and (d)]. Each member that relies on this exemption must evidence that its business entertainment expenses are below the $7,500 threshold.