October 7, 2016

Submitted via email to: pubcom@finra.org

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 16-29
Request for Comment on Proposed Amendments to its Gifts, Gratuities and Non-Cash Compensation Rules

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "**Committee**" or "**we**") of the Business Law Section (the "**Section**") of the American Bar Association (the "**ABA**") in response to the request for comment by the Financial Industry Regulatory Authority, Inc. ("**FINRA**") on proposed amendments to its gifts, gratuities and non-cash compensation rules set forth in Regulatory Notice 16-29 ("**RN 16-29**"). As described in RN 16-29, the proposed amendments would: (1) consolidate the rules on these matters into under a single rule series; (2) increase the gift limit from $100 to $175 per person per year and include a de minimis threshold below which firms would not have to keep records of gifts given or received; (3) amend the non-cash compensation rules to cover all securities products, rather than only direct participation programs (DPPs), variable insurance contracts, investment company securities and public offerings of securities; and (4) incorporate existing guidance and interpretive letters into the rules.

This letter was prepared by members of the Committee's Trading and Markets Subcommittee and FINRA Corporate Financing Rules Subcommittee. Although this letter represents the views of those who have prepared and reviewed it, this letter has not been approved by the ABA's House of Delegates or Board of Governors and, therefore, does not represent the official position of the ABA or the Section.

General Comments

We support FINRA's proposed amendments to consolidate the gifts, gratuities and non-cash compensation rules into one comprehensive rule series that incorporates existing guidance and interpretive letters. We believe this consolidation will help FINRA member firms more easily understand and comply with the requirements for gifts, gratuities and non-cash compensation and will help streamline and simplify other rules, such as Rule 5110, which currently contains references to non-cash compensation items that we believe are confusing in the context of that rule. Nonetheless, we do have some comments and requests for further clarification on the proposal as further detailed below. Please note that we do not respond in this letter to all of the questions posed in RN 16-29 and, in particular, have elected not to comment on those questions relating to estimated costs and anticipated economic impact of the proposed amendments, which we believe can be better addressed directly by affected member firms.

Specific Comments

Below in bold are certain questions posed by FINRA in RN 16-29 followed by the Committee's comments with respect thereto.

1. **The proposed amendments would increase the gift limit under FINRA Rule 3220 and proposed FINRA Rule 3221 to $175. What risks, if any, might arise to customers by raising the gift limit? Should FINRA increase the limit to $175? If not, what, if any, would be an appropriate limit?**

a. Gift Limit.

We believe the current $100 gift limit is too low, particularly given differences in the cost of living in various parts of the United States and elsewhere, and welcome FINRA's proposal to raise this amount. We do not believe that increasing the limit will present any identifiable risks or investor protection concerns. However, we recommend that the limit be increased to $250. This recommendation is based, in part, on the median proposed gift limit determined by responses to FINRA's 2014 survey sent to all member firms. We believe a $250 limit is reasonable, more workable and more in line with present day reality than the inflation-based metric proposed in RN 16-29.

In addition, we also recommend allowing for a principles-based standard for gifts exceeding the $250 limit. Such a "two-pronged" approach would maintain the certainty and simplicity of a uniform fixed amount across member firms, but would allow firms additional flexibility to tailor policies to fit their individual business models and address instances in which a gift above the FINRA-fixed amount would be determined to be appropriate in particular circumstances. Given that the primary reason for the limit on gifts to employees of customers or prospective customers is to minimize the potential conflict of interest that may arise from receipt of such a gift by the employee, we believe this conflict could be avoided by requiring the consent of the

receiving entity. Accordingly, we propose that a member firm be permitted to adopt, in its discretion, additional policies and procedures that would allow associated persons to make gifts in excess of the $250 limit if approved by (i) the firm's legal or compliance department or other appropriately designated internal personnel, and (ii) the general counsel or senior management of the customer or counterparty. Factors that may be relevant to a member firm in approving such a gift may, for example, be whether the gift is to be given to, and shared among, an entire organization or larger department within an organization, or is intended to commemorate a significant milestone. We believe that so long as the customer or counterparty is aware of and has approved the giving of a gift in excess of the FINRA-fixed amount to one or more of its employees, member firms should be allowed to create policies and procedures that set out a mechanism for extending such gifts if they are determined to be reasonable in light of the existing facts and circumstances. Such an approach would be in line with the requirements in connection with gifts to individuals, as further discussed below, and would reflect an appropriate balance between FINRA's investor protection mandate and allowing member firms to design policies and procedures reasonably designed to minimize conflicts of interest.

b. Valuation of Gifts.

With respect to the question of how to value gifts for purposes of the rule set, we note that FINRA has helpfully clarified that for ticketed events, valuation would be the higher of actual cost or face value. With respect to non-ticketed gifts, however, the interpretive guidance states that the value would be the "higher of cost or market value." We believe that the requirement to determine a "market value" for a gift item is too difficult and costly a burden (*e.g.*, does this require getting an appraisal or consulting eBay, auction houses and/or secondhand stores?). Instead, we suggest that the same standard used for ticketed items be used for all gifts – *i.e.*, the higher of actual cost or face value.

2. The Gifts Rule applies to gifts a member firm or its associated persons give and not to gifts the member firm or its associated persons receive. Should the Gifts Rule apply to gifts received as well as gifts given?

We understand that the rationale underlying the limitation on gifts is to prevent a FINRA member or its associated persons from providing gifts that could unduly influence the recipient to steer business from his/her employer to the FINRA member. This same rationale, however, does not apply to the receipt by member firms or associated persons of gifts from customers or prospective customers. That said, we note that many FINRA members have voluntarily adopted policies regarding the receipt of gifts by member firm personnel. Nonetheless, we believe an across-the-board requirement to limit the receipt of gifts is unnecessary, particularly in view of other requirements already

applicable to member firms to supervise the activities of member firm personnel and identify, minimize and manage conflicts of interest.[1]

3. The Gifts Rule does not apply to gifts a member firm gives to its own employees or from a member firm's employee to his or her individual retail clients or customers. Should the Gifts Rule apply to gifts a member firm gives to its own employees or from a member firm's employee to his or her individual retail clients or customers? Please explain.

a. Gifts to Individual Retail Customers.

The absence of a restriction in the current FINRA rulebook on gifts to individual retail customers presumably is based on the recognition that an individual customer does not owe a duty to someone else with respect to the conduct of business and thus is not presented with the same potential conflict of interest faced by a person that is receiving gifts in the context of the person's employment with an entity that is the actual customer of the member firm. Although an individual customer might be motivated to do business with one firm as opposed to another based on the receipt of gifts, we do not believe FINRA should extend the gift limit to such customers. Rather, member firms should be allowed to determine their own policies in this regard.

b. Gifts From Member Firms to Their Own Employees.

As with gifts to individual retail customers, we do not believe the underlying rationale for the gift limitation applies in the context of gifts given by member firms to their own employees. Gifts from employers to employees are quite common and we do not believe over-arching rules prohibiting or limiting such activity are necessary or appropriate. Of course, gifts given by member firm to incentivize inappropriate behavior by member firm personnel would be addressed by other rules applicable to member firms, including, *e.g.*, Rule 2010 and proposed Rule 3221.

[1] We note that proposed Rule 3221 would prohibit FINRA members from accepting any gifts from "offerors" in excess of $175 per person per year. An "offeror" would be defined as: (A) with respect to the sale and distribution of variable contracts, an insurance company, a separate account of an insurance company, an investment company that funds a separate account, any adviser to a separate account of an insurance company or an investment company that funds a separate account, a fund administrator, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act of 1940) of such entities; (B) with respect to the sale and distribution of investment company securities not sold through variable contracts, an investment company, an adviser to an investment company, a fund administrator, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act of 1940) of such entities; and (C) with respect to the sale and distribution of any other type of security, an issuer, sponsor, an adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities." To the extent that FINRA accepts our recommendation to raise the gift limit in Rule 3220 to $250 (or some other amount based on other comments received), we suggest this provision mirror such amount.

4. FINRA is proposing a $50 de minimis threshold below which member firms would not have to keep records of gifts given or received. Is a $50 de minimis threshold appropriate? Should the threshold be higher or lower or should FINRA not include a de minimis threshold?

The proposed $50 de minimis threshold would allow member firms to exclude gifts under $50 when calculating the annual gift limit of $175 per person and members would not need to keep records of gifts valued under $50, provided that a member firm or its associated persons do "not engage in patterns of providing gifts or promotional items of less than $50 to circumvent the Gifts Rule's restrictions and recordkeeping requirements." While this exception initially seems appealing, we are not certain if it will be workable in practice. It would appear that in order to comply with this requirement, member firms will still need to employ a reporting and recordkeeping mechanism designed to monitor gifts given that are under $50 in value so that questionable patterns can be identified and appropriately addressed. Accordingly, we believe that further clarification as to the scope of this exemption will be required. For example, if a registered representative knows an employee of a customer likes flowers, is it within the parameters of the de minimis exemption if he or she sends the employee a bouquet of fresh flowers every week so long as each weekly delivery is below the $50 threshold? In addition, it is not clear to us whether the exemption is intended to apply to all gifts falling below the de minimis threshold (including, *e.g.*, cash, gift cards and ticketed events), or whether the type of gift permitted under the exemption is intended to be more narrow and limited to the kinds of functional items (such as pens and pads) provided as examples in the parenthetical accompanying the provision. FINRA may wish to clarify this as well.

5. Commenters have said that restricting entertainment at training sessions paid for by offerors is logically inconsistent with the rule's business entertainment approach. Should the requirements for training and education meetings allow entertainment that complies with the limitations on business entertainment provided by members?

We believe that FINRA should permit entertainment at training sessions or educational meetings if such entertainment falls within the parameters of proposed Rule 3222. Moreover – and most importantly – we also believe FINRA should add a specific provision in Rule 3220 that expressly carves out "business entertainment" from characterization as a "gift" under that rule. Otherwise, it is not clear how Rules 3220 and 3222 relate to each other, or that business entertainment conducted in compliance with Rule 3222 is indeed not counted toward the gift limit set forth in Rule 3220.

Additional Comments and Requests for Clarification

Proposed Rule 3220(b) – Influencing or Rewarding Employees of Others.

> *(b) This Rule shall not apply to contracts of employment with, or [to] compensation for services rendered by, persons enumerated in paragraph (a) provided that there is inexistence prior to the time of employment or before the services are rendered, a written agreement between the member and the person who is to be employed to perform such services. Such agreement shall include the nature of the proposed employment, the amount of the proposed compensation, and the written consent of such person's employer or principal*.

We recognize that the foregoing provision is largely unchanged from the language set forth in current Rule 3220(b), but we believe it is confusing as written and may have unintended consequences. We understand this provision to exclude ordinary employment relationships between member firms and their own employees (who may also be employees of others) from the gift rule, such that compensation provided to a member firm's own employees is not considered a prohibited "gift" or "gratuity." For example, a member firm might employ an individual who is also employed by an investment adviser or bank that is affiliated with the member firm. Or the "dual" employee may be employed by a third party that is not affiliated with the member firm, but maintains an account at, and receives services from, the member firm. Often, member firm personnel do not enter into formal employment contracts with such "dual employees" or may engage persons as "independent contractors" and not statutory "W-2" employees. Moreover, the amount of proposed compensation may not be known at the time or may be based on factors that could produce highly variable compensation over time. It is not clear to us that this provision adequately addresses such arrangements and, indeed, may be read as requiring formal employment arrangements and employment contracts, which is not the norm, particularly for lower-level personnel. We suggest that this provision be modified and simplified to exclude compensation provided under such circumstances if the other employer is notified of the arrangement (including, if deemed necessary, the general basis on which the employee may be compensated) and does not object to the employee continuing in a dual capacity.

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We appreciate the opportunity to comment on the proposed rule changes and thank FINRA staff in advance for their consideration of our suggestions and requests for clarification. To the extent helpful, we are available to discuss these matters further and to respond to any additional questions.

Sincerely,

/s/ David M. Lynn

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Chair, Federal Regulation of Securities Committee

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