

## Gifts, Gratuities and Non-Cash Compensation Rules

### FINRA Requests Comment on Proposed Amendments to Its Gifts, Gratuities and Non-Cash Compensation Rules

Comment Period Expires: September 23, 2016

#### Executive Summary

FINRA is seeking comment on proposed amendments to FINRA Rule 3220 (Influencing or Rewarding Employees of Others), as well as on proposed FINRA Rule 3221 (Restrictions on Non-Cash Compensation), and proposed FINRA Rule 3222 (Business Entertainment).

The proposed rule text is available in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Victoria Crane, Associate General Counsel, Office of General Counsel, at (202) 728-8104; or
- ▶ Joseph Savage, Vice President and Counsel, Regulatory Policy, at (240) 386-4534.

#### Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by September 23, 2016.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:  
Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

#### August 2016

##### Notice Type

- ▶ Request for Comment

##### Suggested Routing

- ▶ Compliance
- ▶ Investment Companies
- ▶ Legal
- ▶ Registered Representatives
- ▶ Senior Management
- ▶ Variable Contracts

##### Key Topics

- ▶ Business Entertainment
- ▶ Commercial Bribery
- ▶ Gifts
- ▶ Gratuities
- ▶ Non-Cash Compensation

##### Referenced Rules & Notices

- ▶ FINRA Rule 2310
- ▶ FINRA Rule 2320
- ▶ FINRA Rule 3220
- ▶ FINRA Rule 3221
- ▶ FINRA Rule 3222
- ▶ FINRA Rule 5110
- ▶ NASD Rule 2830
- ▶ Notice to Members 06-69

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>1</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).<sup>2</sup>

## Background & Discussion

In April 2014, FINRA launched a retrospective review of its gifts, gratuities and non-cash compensation rules to assess their effectiveness and efficiency. In December 2014, FINRA published a report on its review.<sup>3</sup> The report concluded that while the rules have met their intended investor protection objectives, they could benefit from some updating to better align the investor protection benefits and the economic impacts. To that end, FINRA recommended exploring a combination of proposed rule amendments and guidance.

As discussed further below, FINRA is proposing amendments to the gifts, gratuities and non-cash compensation rules to, among other things: (1) consolidate the rules under a single rule series in the FINRA rulebook; (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.

In addition, FINRA is proposing a revised approach to internal sales contests for non-cash compensation such that if payment or reimbursement of expenses associated with the non-cash compensation arrangement is preconditioned on achievement of a sales target, the non-cash compensation arrangement must: (1) be based on the total production with respect to all securities products; and (2) not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities.

Finally, FINRA is proposing to incorporate into the amended rules a principles-based standard for business entertainment that would require firms to adopt written policies and supervisory procedures for business entertainment.

## Proposed Rule Amendments

### A. Gifts

FINRA Rule 3220 (Influencing or Rewarding Employees of Others)<sup>4</sup> (the Gifts Rule) prohibits any member or person associated with a member, directly or indirectly, from giving anything of value in excess of \$100 per year to any person where such payment is in relation to the business of the recipient's employer. The rule also requires members to keep separate records regarding gifts and gratuities.<sup>5</sup> The rule seeks both to avoid improprieties that may arise when a member firm or its associated persons give anything of value to an employee of a customer or counterparty and to preserve an employee's duty to act in the best interests of that customer.

#### 1. \$100 Gift Limit

FINRA proposes to increase the gift limit from \$100 to \$175 per person per year.<sup>6</sup> FINRA believes that an increase in the gift limit to \$175 is appropriate because it takes into account the rate of inflation since adoption of the \$100 gift limit.<sup>7</sup>

#### 2. Incorporation of Existing Guidance and Interpretive Positions

In 2006, FINRA issued [Notice to Members \(NTM\) 06-69](#) addressing gifts and business entertainment to clarify the gifts that are subject to the Gifts Rule; that members must aggregate all gifts given by the firm and its associated persons to a particular recipient over the course of a year; the manner by which to value gifts; and the supervision and recordkeeping requirements for gifts.<sup>8</sup> In addition, over the years, in response to inquiries regarding the Gifts Rule, the staff has issued various interpretive letters, including a letter regarding the application of the Gifts Rule to bereavement gifts.<sup>9</sup>

FINRA proposes to incorporate, without material change, the guidance in *NTM 06-69* as well as its interpretation regarding the application of the Gifts Rule to bereavement gifts into FINRA Rule 3220 as Supplementary Material. Thus, the Supplementary Material would provide that: (1) there is no express exclusion from the Gifts Rule for gifts given during the course of business entertainment, unless the gift is of *de minimis* value, or a promotional or commemorative item; (2) gifts must be valued at the higher of cost or market value;<sup>10</sup> (3) members must aggregate all gifts given by the member and each associated person of the member to a particular recipient over the course of the year; (4) bereavement gifts that are customary and reasonable are not considered to be in relation to the business of the recipient and, therefore, are not subject to the restrictions of the Gifts Rule or its recordkeeping requirements; (5) gifts given for infrequent life events (*e.g.*, a wedding gift or congratulatory gift for the birth of a child) are not subject to the restrictions of the Gifts Rule or its recordkeeping requirements provided the gifts are customary and reasonable, personal in nature and not in relation to the business of the employer of the recipient; and

(6) gifts of a *de minimis* value, promotional items of nominal value and commemorative items are not subject to the restrictions of the Gifts Rule or its recordkeeping requirements provided they meet the conditions specified in the Supplementary Material.<sup>11</sup> In addition, FINRA proposes to incorporate into the Supplementary Material to FINRA Rule 3220 the guidance in [NTM 06-69](#) regarding supervision and recordkeeping requirements for gifts.

## B. Restrictions on Non-Cash Compensation

FINRA and NASD rules generally prohibit members and their associated persons from directly or indirectly accepting or making payments or offers of non-cash compensation in connection with the sale of variable insurance contracts,<sup>12</sup> investment company securities,<sup>13</sup> DPPs<sup>14</sup> and the public offerings of debt and equity securities.<sup>15</sup> These prohibitions are subject to specified exceptions that permit:

- ▶ gifts that do not exceed an annual amount per person fixed by the FINRA Board of Governors (currently \$100) and are not preconditioned on achievement of a sales target;
- ▶ an occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target;
- ▶ payment or reimbursement by “offerors” (product issuers, advisers, underwriters and their affiliates) in connection with training or education meetings, subject to specified conditions, including meeting location restrictions and not preconditioning attendance on achievement of a sales target; and
- ▶ internal firm non-cash compensation arrangements that are based on total production and equal weighting of product sales.<sup>16</sup>

### 1. Proposed FINRA Rule 3221

#### a. Application to Any Security

FINRA believes that the general prohibitions regarding the payment or receipt of non-cash compensation should be extended beyond investment company securities, variable insurance contracts, DPPs and public offerings of securities as the conflicts underlying these prohibitions exist with respect to all securities. Accordingly, FINRA proposes to eliminate the existing non-cash compensation rules and replace them with proposed FINRA Rule 3221, which would apply to the payment or receipt of non-cash compensation in connection with the sale of any security. Specifically, proposed FINRA Rule 3221(b) would provide that “No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation in connection with the sale of securities.” This prohibition would be subject to the exceptions discussed below.

b. Exceptions to the Prohibition on Non-Cash Compensation Arrangements

i. Gifts From Offerors

Consistent with the existing non-cash compensation rules, the proposal would except from the prohibitions on non-cash compensation arrangements gifts from offerors<sup>17</sup> that do not exceed a specified threshold per individual per year and are not preconditioned on the achievement of a sales target.

The proposal would define the term “preconditioned on the achievement of a sales target” as describing a non-cash compensation arrangement in which an offeror or member communicates in advance that an associated person will receive non-cash compensation only if the associated person achieves either a dollar-denominated goal for selling securities or a goal of finishing within a defined number of top sellers of securities.<sup>18</sup> As with the dollar threshold under the proposed amendments to the Gifts Rule, FINRA proposes to limit the gifts exception under proposed FINRA Rule 3221 to \$175.

ii. Training or Education Meetings

The proposal would permit an offeror to make payments or reimbursements of associated persons’ expenses in connection with a training or education meeting held by an offeror or a member, provided that the meeting meets the following conditions:

- ▶ Associated persons must obtain the member’s prior approval to attend the meeting and attendance, as well as the payment or reimbursement by the offeror, must not be preconditioned on the achievement of a sales target.
- ▶ The location must be appropriate to the purpose of the meeting. The proposal would establish appropriate locations to be a U.S. office of the offeror or member holding the meeting, a facility located in the vicinity of such office, a U.S. regional location with respect to meetings of associated persons who work within that region or, with respect to meetings dealing with DPPs or real estate investment trusts (REITs), a U.S. location at which a significant or representative asset of the program or REIT is located.
- ▶ Payment or reimbursement by the offeror must apply only to the training, education, meals, lodging and transportation for associated persons. The proposed rule would make clear that the offeror could not pay or provide reimbursement for the entertainment or expenses of guests of associated persons or for the entertainment of associated persons.
- ▶ FINRA believes that the conditions relating to training or education meetings are largely consistent with the restrictions relating to such meetings in the existing non-cash compensation rules as well as staff interpretations relating to those rules.<sup>19</sup>

### iii. Internal Sales Contests

The existing non-cash compensation rules permit non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that: (1) the member's or non-member's non-cash compensation arrangement, if it includes variable contract securities or investment company securities, is based on the total production of associated persons with respect to all variable contract securities or investment company securities, as applicable, distributed by the member; (2) the non-cash compensation arrangement requires that the credit received for each variable contract security or investment company security, as applicable, is equally weighted; (3) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and (4) the recordkeeping requirement relating to member compensation is satisfied.<sup>20</sup>

FINRA proposes to continue to permit non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member if payment or reimbursement of expenses associated with the non-cash compensation arrangement is not preconditioned on achievement of a sales target. If payment or reimbursement is preconditioned on achievement of a sales target, the non-cash compensation arrangement must: (1) be based on the total production of associated persons with respect to all securities distributed by the member; and (2) not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities. In addition, no unaffiliated non-member company or other unaffiliated member may directly or indirectly participate in the member's or non-member's organization of a permissible non-cash compensation arrangement.<sup>21</sup>

Thus, the proposal would permit members to continue to pay non-cash compensation to their associated persons outside the context of an internal sales contest. For example, this provision would permit a member to send its associated persons to an internal training meeting that is not tied to achievement of a sales target. The meeting would not have to meet the same requirements as a training or education meeting sponsored by a third-party offeror, but no unaffiliated entity could participate in the organization of these types of arrangements.

Unlike the existing non-cash compensation rules, however, the proposal would not permit product-specific internal sales contests. FINRA believes that internal sales contests that favor one security (*e.g.*, a proprietary investment company) or one type of security (*e.g.*, investment companies or stocks) potentially create an incentive to engage in sales conduct contrary to the best interests of customers. Consequently, "stock of the day" and similar promotions would be impermissible under the proposal.

Although the proposed rule change relating to internal sales contests is a significant substantive change to the existing rules, FINRA's impression is that product-specific internal sales contests for non-cash compensation are not widely used today. Moreover, to the extent that firms engage in internal sales contests, FINRA believes that requiring payment or reimbursement to be based on the total production of associated persons with respect to all securities distributed by the member and not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities would reduce the potential for conflicts of interest and risk of abuse.

**c. Incorporation of Existing Guidance and Interpretive Positions**

FINRA proposes to incorporate into proposed FINRA Rule 3221 as Supplementary Material language similar to the language discussed above in connection with the proposed Supplementary Material to the Gifts Rule. Thus, the Supplementary Material would provide that: (1) there is no express exclusion from the restrictions in the non-cash compensation rule for gifts given during the course of business entertainment, unless the gift is of a *de minimis* value, or a promotional or commemorative item; (2) gifts must be valued at the higher of cost or market value;<sup>22</sup> (3) members must aggregate all gifts given by the member and each associated person of the member to a particular recipient over the course of the year; (4) gifts given for infrequent life events (*e.g.*, a wedding gift or congratulatory gift for the birth of a child) are not subject to the restrictions of the non-cash compensation rule or its recordkeeping requirements provided the gifts are customary and reasonable and personal in nature; and (5) gifts of a *de minimis* value, promotional items of nominal value and commemorative items are not subject to the restrictions of the non-cash compensation rule provided they meet the conditions specified in the Supplementary Material.<sup>23</sup>

In addition, FINRA proposes to incorporate into the Supplementary Material prior guidance it has provided regarding training or education meetings. Specifically, the Supplementary Material would provide that the proposed rule's training or education exception "must first and foremost be intended to provide training or education to an associated person. Any training must occupy substantially all of the work day. Payment or reimbursement for any related meals, lodging and transportation is permissible, but reimbursement or payment for outings (*e.g.*, golf outings), tours, or other forms of entertainment while at the location for the purpose of training or education is impermissible."<sup>24</sup>

**d. Recordkeeping**

The proposal would require a member to retain records of all non-cash compensation provided or received by the member or its associated persons for arrangements permitted under the proposed rule. The records must include: the names of the offerors, non-members or other members making the non-cash compensation contribution; the names of associated persons receiving the non-cash compensation under the arrangements; the nature and value of non-cash compensation provided or received; the location of training or education meetings; and any other information that evidences compliance by the member and its associated persons with the rule.

The proposed recordkeeping requirements differ from the existing non-cash compensation rules' recordkeeping requirements in that the proposal would require members to retain records of non-cash compensation provided or received by a member or its associated person. The existing non-cash compensation rules require members to maintain records of non-cash compensation received by a member or its associated persons. FINRA believes it would be important for members to retain records of non-cash compensation provided and received to help ensure that members comply with the provisions of the non-cash compensation rule.

### C. Business Entertainment

In 1999, FINRA staff issued an interpretive letter stating that the Gifts Rule does not prohibit "ordinary and usual business entertainment" (such as an occasional meal, sporting event, theater production or comparable entertainment event) provided that the entertainment "is neither so frequent nor so extensive as to raise any question of propriety."<sup>25</sup> The 1999 letter noted that the interpretation was based, in part, on FINRA's rules governing non-cash compensation in connection with the offer and sale of investment company shares and variable annuities.

FINRA proposes to replace the business entertainment standard in the existing non-cash compensation rules and 1999 letter with proposed FINRA Rule 3222, which would require each member to adopt written policies and supervisory procedures relating to business entertainment tailored to its business needs.<sup>26</sup> The proposed rule would explicitly address the content of those policies and procedures and would incorporate elements of the business entertainment standard in the existing non-cash compensation rules and the 1999 letter. Specifically, proposed FINRA Rule 3222 would require that each member's written policies and supervisory procedures: (1) are designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived as intended as, an improper *quid pro quo*; (2) define forms of permissible and impermissible business entertainment based on the location, nature, frequency and dollar amount of the business entertainment provided, as well as the type and dollar amount of any accommodations or transportation provided in connection with such business entertainment;<sup>27</sup> (3) require that the offeror, member or one or more of the member's associated persons hosts the business entertainment; (4) specify that the business entertainment must not be preconditioned on the achievement of a sales target; and (5) require appropriate training and education of all personnel who supervise, administer or are subject to the written policies and supervisory procedures.

In addition, the proposed rule change would require that each member's written policies and supervisory procedures must require the maintenance of detailed records of business entertainment expenses, including the names of all persons providing and receiving business entertainment, the location, nature, frequency and dollar amount of the business entertainment, and the type and dollar amount of any accommodations or transportation provided.



## Economic Impact Assessment

### Regulatory Need

The assessment phase of FINRA's retrospective review of the gifts, gratuities and non-cash compensation rules concluded that these rules have been largely effective in meeting their intended investor protection objectives, but there are certain areas where the investor protection benefits may not align with the associated economic costs. For example, the views expressed by the stakeholders during the assessment suggested that a \$100 gift limit is too low and that raising the limit would not undermine the purposes of the gifts and non-cash compensation rules. Stakeholders also raised concerns that the gifts, gratuities and non-cash compensation rules are scattered throughout the FINRA rulebook causing difficulties from a reference and compliance standpoint.

The amendments in this rule proposal are intended to address these current limitations and better align the investor protection benefits and the economic impacts.

### Economic Impacts

The proposed amendments would directly impact member firms that regularly engage in gift giving and non-cash compensation arrangements. The proposed consolidation of the rules under a single rule series in the FINRA rulebook should simplify the supervisory efforts and could potentially lead to better use of compliance resources elsewhere within the firms. The increase in the gift limit from \$100 to \$175 per person per year reflects the rate of inflation since adoption of the \$100 gift limit, and addresses the increase in not only the prices of goods, but also the shipping costs, taxes and other expenses. Furthermore, the inclusion of a *de minimis* threshold below which firms would not have to keep records of gifts given or received, and the exception regarding gifts related to specified life events—such as bereavement and wedding gifts, or gifts for the birth of a child—should reduce the costs associated with tracking and supervising such instances.

The proposal extends the general prohibitions regarding the payment or receipt of non-cash compensation in connection with the sale of investment company securities, variable insurance products, DPPs and public offerings of securities to the sale of all securities products. As mentioned above, such prohibitions on the payment or receipt of non-cash compensation are covered in several FINRA rules,<sup>28</sup> so only firm activities that fall outside the scope of the current rules would be impacted by the proposed extension. FINRA identified that a potential area that would be impacted is private placements of securities. Between December 2012 and March 2016, there were 6,702 private placements facilitated by 750 FINRA member firms. While FINRA understands that, due to the nature of the private placements, accepting or making payments or offers of non-cash compensation is not a common industry practice, there may still be instances where the proposed rule may potentially apply.

The proposal also requires member firms to adopt written policies and supervisory procedures to maintain detailed records of business entertainment expenses. Member firms that have no relevant policies and supervisory procedures in place must dedicate compliance resources to recording and tracking such expenses. In the past several years, FINRA's examination staff has found instances of poor recordkeeping of such expenses. Specifically, the firms' logs that were used to record gifts and business entertainment did not indicate the recipient of each employee's expenditures or its intended business purpose. Member firms are expected to benefit from the reinforcement of more effective recordkeeping requirements. Moreover, the proposed rule would establish a principles-based standard that would allow firms to tailor their written policies and supervisory procedures to meet their business needs and to take a risk-based approach, so that they can allocate compliance resources to more significant issues.

FINRA also considered the potential impacts of the proposed amendments on investors. FINRA believes the proposed prohibition of product-specific internal sales contests, which typically favor one security or one type of security, reduces the potential for sales of products that are not aligned with the best interests of customers.

## Request for Comment

FINRA requests comment on all aspects of the proposed rules, including any potential costs and burdens of the proposed rules. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA particularly requests comment on the following questions:

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?
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?
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.
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?

5. To what extent would FINRA's proposal to no longer allow product-specific internal sales contests for non-cash compensation impact member firms? In what ways, if any, could it potentially impact customers? Is FINRA's proposed approach to internal sales contests for non-cash compensation appropriate? Please explain.
6. 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?
7. Are the proposed recordkeeping requirements appropriately tailored to obtain information that would be relevant for purposes of monitoring for compliance with the proposed rules?
8. What are the estimated costs of drafting policies and procedures to comply with proposed Rule 3222 relating to business entertainment?
9. How would the consolidation of the rules governing gifts, gratuities and non-cash compensation in this proposal simplify compliance? What impact would it have on the costs of compliance?
10. What economic impact, if any, would be associated with the extension of the rules governing non-cash compensation to all securities?
11. Are there any expected economic impacts associated with the proposed rules not discussed in this *Notice*? What are they and what are the estimates of those impacts?

## Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
3. See *Retrospective Rule Review Report: Gifts, Gratuities and Non-Cash Compensation* (December 2014).
4. In 2008, the SEC approved the transfer of NASD Rule 3060 into the Consolidated FINRA Rulebook without material change and renumbered the rule as FINRA Rule 3220.
5. See FINRA Rule 3220(c).
6. The current \$100 gift limit has been in place since 1992, when the SEC approved an increase in the limit from \$50 to \$100. See Securities Exchange Act Release No. 31662 (December 28, 1992), 58 FR 370 (January 5, 1993) (Order Approving File No. SR-NASD-92-40). See also Securities Exchange Act Release No. 21074 (June 20, 1984), 49 FR 26330 (June 27, 1984) (Order Approving File No. SR-NASD-84-8) (increasing the gift limit from \$25 to \$50).
7. FINRA staff used the annual rate of inflation data for the United States from the [Federal Reserve Bank of St. Louis website](#) to estimate the change in consumer prices since 1992, when the SEC approved the increase in the limit from \$50 to \$100. The average rate of inflation over the 26 years is 2.34 percent and the compound increase in consumer prices over the period is 74.03 percent. Applying this increase to the \$100 gift limit results in \$174.03.
8. See *NTM 06-69* (December 2006).
9. See letter from Gary L. Goldsholle, Vice President & Associate General Counsel, FINRA, to Amal Aly, Managing Director & Associate General Counsel, SIFMA, dated December 17, 2007 (“Aly Letter”). In 1999, the staff issued an interpretive letter stating that the Gifts Rule does not prohibit “ordinary and usual business entertainment” provided that the entertainment “is neither so frequent nor so extensive as to raise any question of propriety.” That letter is discussed in more detail below in connection with proposed FINRA Rule 3222.
10. Tickets to sporting or other events would be valued at the higher of cost or face value.
11. In *NTM 06-69*, the staff stated that for a promotional item to be considered of nominal value its value must be substantially below \$100. In addition, the staff did not specify in *NTM 06-69* at what value it would consider a gift to be of *de minimis* value. Under the proposed rule change, FINRA proposes that gifts of *de minimis* value or promotional items of nominal value would not be subject to the restrictions of the Gifts Rule or its recordkeeping requirements provided that the value of the gift or promotional item is below \$50. A firm or its associated persons may not engage in patterns of providing gifts or promotional items of less than \$50 to circumvent the Gifts Rule’s restrictions and recordkeeping requirements.

12. See FINRA Rule 2320(g)(4) (Variable Contracts of an Insurance Company).
13. See NASD Rule 2830(l)(5) (Investment Company Securities).
14. See FINRA Rule 2310(c) (Direct Participation Programs).
15. See FINRA Rule 5110(h) (Corporate Financing Rule – Underwriting Terms and Arrangements).
16. See NASD Rule 2830(l)(5) and FINRA Rule 2320(g)(4). FINRA Rules 5110 and 2310 do not require internal firm non-cash compensation arrangements in connection with public offerings of securities or direct participation programs to be based on total production and equal weighting of product sales.
17. The proposed definition of “offeror” is based on the current definitions of “offeror” in the existing non-cash compensation rules. Specifically, the proposal would define the term “offeror” to mean: “(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.”
18. To fall within this definition, a communication may be either explicit or implicit. Thus, an arrangement normally would not be considered preconditioned on the achievement of a sales target if a member or an offeror designates persons to participate in the arrangement in recognition of past sales, without stating the goal in advance. If, however, after several events, the selection criteria of the member or offeror becomes reasonably apparent, there may have been an implicit communication of a goal, and any similar arrangement in the future might be deemed preconditioned on the achievement of a sales target.
19. See, e.g., [“Non-Cash Compensation – Training or Education Meetings,” NASD Regulatory & Compliance Alert 13](#) (Summer 2000), (interpreting the training or education meeting exception in the existing non-cash compensation rules “as an event that is first and foremost intended to provide training or education to an associated person. Any training meeting should occupy substantially all of the work day.”). FINRA subsequently published a letter reminding offerors that they may not pay for entertainment expenses of training or education meeting attendees. See [letter](#) from Mary L. Schapiro, President, NASD (March 7, 2001).
20. The total production and equal weighting requirements do not apply to arrangements involving DPPs or public offerings of securities.

21. Consistent with the existing non-cash compensation rules, the proposal would include a provision that would permit contributions by a non-member company or other member to a non-cash arrangement between a member and its associated persons, or contributions by a member to a non-cash compensation arrangement of a non-member, provided that it meets the requirements for such arrangements, including the total production standard.
22. As stated above, tickets to sporting or other events would be valued at the higher of cost or face value.
23. Consistent with the Gifts Rule, FINRA proposes a \$50 *de minimis* threshold. In addition, the proposal would specify that gifts of *de minimis* value, promotional items of nominal value and commemorative items would not be subject to the proposed recordkeeping requirements relating to non-cash compensation arrangements.
24. *See supra* note 19.
25. *See* [letter](#) from R. Clark Hooper, Executive Vice President, NASD, to Henry H. Hopkins, Director, and Sarah McCafferty, Vice President, T. Rowe Price Investment Services, Inc., dated June 10, 1999 (“1999 letter”).
26. FINRA proposes to include in Supplementary Material to proposed FINRA Rule 3222 language that makes clear that the purpose of the rule is to govern business entertainment provided by a member or its associated persons, as well as business entertainment accepted by a member or its associated persons from an offeror. In addition, the Supplementary Material would provide that business entertainment includes, but is not limited to, an occasional meal, a ticket to an event (*e.g.*, sporting event) or theater and other comparable entertainment.
27. FINRA notes that a principles-based, rather than prescriptive, approach to what is permissible and impermissible business entertainment would satisfy this requirement of proposed Rule 3222.
28. *See supra* notes 12-15.

## ATTACHMENT A

Below is the text of the amendments. New language is underlined; deletions are in brackets.

\* \* \* \* \*

### 3220. Influencing or Rewarding Employees of Others

(a) No member or person associated with a member shall, directly or indirectly, give or permit to be given anything of value, including gratuities, in excess of [one hundred dollars] \$175 per individual per year to any person, principal, proprietor, employee, agent or representative of another person where such payment or gratuity is in relation to the business of the employer of the recipient of the payment or gratuity. A gift of any kind is considered a gratuity.

(b) This Rule shall not apply to contracts of employment with<sub>2</sub> or [to] compensation for services rendered by<sub>2</sub> persons enumerated in paragraph (a) provided that there is in existence 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.

(c) Subject to Supplementary Material .07, a[A] separate record of all payments or gratuities under this Rule in any amount known to the member, the employment agreement referred to in paragraph (b) and any employment compensation paid as a result thereof<sub>2</sub> shall be retained by the member for the period specified by SEA Rule 17a-4.

• • • Supplementary Material: -----

**.01 Gifts Incidental to Business Entertainment.** There is no express exclusion from the restrictions in paragraph (a) of this Rule for gifts given during the course of business entertainment, unless the gift is of de minimis value, or a promotional or commemorative item consistent with Supplementary Material .06.

**.02 Valuation of Gifts.** Gifts must be valued at the higher of cost or market value, exclusive of tax and delivery charges. When valuing tickets for sporting or other events, a member must use the higher of cost or face value. If gifts are given to multiple recipients, members must record the names of each recipient and calculate and record the value of the gift on a pro rata per recipient basis, for purposes of ensuring compliance with the \$175 limit in paragraph (a) of this Rule.

**.03 Aggregation of Gifts.** Members must aggregate all gifts given by the member and each associated person of the member to a particular recipient over the course of the year. In addition, each member must state in its procedures whether it is aggregating all gifts given by the member and its associated persons on a calendar year, fiscal year, or on a rolling basis beginning with the first gift to any particular recipient.

**.04 Bereavement Gifts.** Bereavement gifts that are customary and reasonable are not considered to be in relation to the business of the employer of the recipient and, therefore, are not subject to the restrictions in paragraph (a) of this Rule or the recordkeeping requirements in paragraph (c) of this Rule.

**.05 Personal Gifts.** Gifts that are given for infrequent life events (*e.g.*, a wedding gift or a congratulatory gift for the birth of a child) are not subject to the restrictions in paragraph (a) of this Rule or the recordkeeping requirements in paragraph (c) of this Rule, provided the gifts are customary and reasonable, personal in nature and not in relation to the business of the employer of the recipient. In determining whether a gift is “personal in nature and not in relation to the business of the employer of the recipient,” members should consider a number of factors, including the nature of any pre-existing personal or family relationship between the person giving the gift and the recipient and whether the associated person paid for the gift. When the member bears the cost of the gift, either directly or by reimbursing an associated person, FINRA presumes that such gift is not personal in nature and instead is in relation to the business of the employer of the recipient.

**.06 De Minimis Gifts and Promotional or Commemorative Items.** (a) Gifts of a de minimis value (*e.g.*, pens, notepads or modest desk ornaments) or promotional items of nominal value that display the member’s logo (*e.g.*, umbrellas, tote bags or shirts) are not subject to the restrictions in paragraph (a) of this Rule provided that the value of the gift or promotional item is below \$50. (b) Customary Lucite stones, plaques or other similar solely decorative items commemorating a business transaction are not subject to the restrictions in paragraph (a) of this Rule. The restrictions of this Rule shall apply, however, where the item is not solely decorative, irrespective of whether the item was intended to commemorate a business transaction.

**.07 Supervision and Recordkeeping.** Paragraph (c) of this Rule requires a separate record of payments and gratuities. Rule 3110 requires a member to have a supervisory system reasonably designed to achieve compliance with Rule 3220. To meet these standards, members are required to have systems and procedures reasonably designed to ensure that payments and gratuities in relation to the business of the employer of the recipient given



by the member and its associated persons to employees of clients of the member are: (i) reported to the member; (ii) reviewed for compliance with this Rule; and (iii) maintained in the member's records. Such procedures must include provisions reasonably designed to ensure that supervisory personnel, other than the associated person who gives or is permitted to give a payment or gratuity, determines whether such payment or gratuity is personal in nature rather than in relation to the business of the recipient's employer. Gifts of *de minimis* value or nominal promotional or commemorative items consistent with Supplementary Material .06 are not subject to the recordkeeping requirements of paragraph (c) of this Rule.

### **3221. Restrictions on Non-Cash Compensation**

#### **(a) Definitions**

(1) "Affiliated Member" shall mean a member that, directly or indirectly, controls, is controlled by or is under common control with a non-member company.

(2) "Cash compensation" shall mean any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override or cash employee benefit received in connection with the sale and distribution of securities.

(3) "Non-cash compensation" shall mean any form of compensation that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(4) "Offeror" shall mean:

(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, a sponsor, an adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities.

(5) "Preconditioned on the achievement of a sales target" shall describe a non-cash compensation arrangement in which an offeror or member communicates in advance that an associated person will receive non-cash compensation only if the associated person achieves either a dollar-denominated goal for selling securities or a goal of finishing within a defined number of top sellers of securities.

(b) Non-Cash Compensation Arrangements

No member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation in connection with the sale of securities, except the following:

(1) Gifts from offerors that do not exceed \$175 per individual per year and are not preconditioned on the achievement of a sales target.

(2) Payment or reimbursement by an offeror in connection with a meeting held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(A) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned on the achievement of a sales target;

(B) the location is appropriate to the purpose of the meeting, which shall mean a United States office of the offeror or the member holding the meeting, or a facility located in the vicinity of such office, or a United States regional location with respect to meetings of associated persons who work within that region or, with respect to meetings dealing with direct participation programs or real estate investment trusts, a United States location at which a significant or representative asset of the program or real estate investment trust is located;

(C) the payment or reimbursement applies only to training, education, meals, lodging and transportation for associated persons and is not applied to the entertainment or expenses of guests of associated persons or to the entertainment of associated persons; and

(D) the payment or reimbursement by the offeror is not preconditioned on the achievement of a sales target.

(3) Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an Affiliated Member, provided that:

(A) (i) payment or reimbursement of expenses associated with the non-cash compensation arrangement is not preconditioned on the achievement of a sales target; or

(ii) if payment or reimbursement of expenses associated with the non-cash compensation arrangement is preconditioned on the achievement of a sales target, the non-cash compensation arrangement is:

(a) based on the total production of associated persons with respect to all securities distributed by the member; and

(b) not based on conditions that would encourage an associated person to recommend particular securities or categories of securities; and

(B) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement.

(4) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, or contributions by a member to a non-cash compensation arrangement of a non-member, provided that the arrangement meets the criteria in paragraph (b)(3).

(c) Recordkeeping

A member shall retain records of all non-cash compensation provided or received by the member or its associated persons for arrangements permitted by paragraph (b) for the period specified by SEA Rule 17a-4. The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contribution; the names of associated persons receiving the non-cash compensation under the arrangements; the nature and value of non-cash compensation provided or received; the location of training or education meetings; and any other information that evidences compliance by the member and its associated persons with paragraph (b).

••• **Supplementary Material:** -----

**.01 Gifts Incidental to Business Entertainment.** There is no express exclusion from the restrictions in paragraph (b) of this Rule for gifts given during the course of business entertainment, unless the gift is of *de minimis* value, or a promotional or commemorative item consistent with Supplementary Material .05.

**.02 Valuation of Gifts.** Gifts must be valued at the higher of cost or market value, exclusive of tax and delivery charges. When valuing tickets for sporting or other events, a member must use the higher of cost or face value. If gifts are given to multiple recipients, members must record the names of each recipient and calculate and record the value of the gift on a pro rata per recipient basis, for purposes of ensuring compliance with the \$175 limit in paragraph (b) of this Rule.

**.03 Aggregation of Gifts.** Members must aggregate all gifts received or given by the member and each associated person of the member over the course of the year for purposes of ensuring compliance with the \$175 limit in paragraph (b) of this Rule. In addition, each member must state in its procedures whether it is aggregating all gifts received or given by the member and its associated persons on a calendar year, fiscal year, or on a rolling basis beginning with the first gift received or given.

**.04 Personal Gifts.** Gifts that are given for infrequent life events (*e.g.*, a wedding gift or a congratulatory gift for the birth of a child) are not subject to the restrictions in paragraph (b), or the recordkeeping requirements of paragraph (c), of this Rule provided the gifts are customary and reasonable and personal in nature.

**.05 De Minimis Gifts and Promotional or Commemorative Items.** (a) Gifts of a *de minimis* value (*e.g.*, pens, notepads or modest desk ornaments) or promotional items of nominal value that display the offeror's logo (*e.g.*, umbrellas, tote bags or shirts) are not subject to the restrictions in paragraph (b) of this Rule provided that the value of the gift or promotional item is below \$50. (b) Customary Lucite stones, plaques or other similar solely decorative items commemorating a business transaction are not subject to the restrictions in paragraph (b) of this Rule. The restrictions of this Rule shall apply, however, where the item is not solely decorative, irrespective of whether the item was intended to commemorate a business transaction. Gifts of *de minimis* value or nominal promotional or commemorative items consistent with Supplementary Material .05 are not subject to the recordkeeping requirements of paragraph (c) of this Rule.

**.06 Training or Education Meetings.** The training or education exception in paragraph (b)(2) of this Rule must first and foremost be intended to provide training or education to an associated person. Any training must occupy substantially all of the work day. Payment or reimbursement for any related meals, lodging and transportation is permissible, but reimbursement or payment for outings (e.g., golf outings), tours, or other forms of entertainment while at the location for the purpose of training or education is impermissible. In addition, there is no express exclusion from the restrictions in paragraph (b) of this Rule for gifts given during the course of training or education meetings, unless the gift is of de minimis value, or a promotional or commemorative item consistent with Supplementary Material .05.

### **3222. Business Entertainment**

(a) Each member that engages in business entertainment must have written policies and supervisory procedures with respect to business entertainment that:

(1) Are designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived as intended as, an improper quid pro quo;

(2) Define forms of permissible and impermissible business entertainment based on the location, nature, frequency and dollar amount of the business entertainment provided, as well as the type and dollar amount of any accommodations or transportation provided in connection with such business entertainment;

(3) Require that the offeror, member or one or more of the member's associated persons hosts the business entertainment;

(4) Specify that the business entertainment must not be pre-conditioned on the achievement of a sales target; and

(5) Require appropriate training and education of all personnel who supervise, administer or are subject to the written policies and supervisory procedures.

(b) Each member's written policies and supervisory procedures must require the maintenance of detailed records of business entertainment expenses, including the names of all persons providing and receiving the business entertainment, the location, nature, frequency and dollar amount of the business entertainment, and the type and dollar amount of any accommodations or transportation provided.

• • • **Supplementary Material:** -----

**.01 Definitions.** The terms “offeror” and “preconditioned on the achievement of a sales target” shall have the same meanings as in Rule 3221.

**.02 Purpose.** The purpose of Rule 3222 is to govern business entertainment provided by a member or its associated persons, as well as business entertainment accepted by a member or its associated persons from an offeror. Business entertainment includes, but is not limited to, an occasional meal, a ticket to an event (e.g., sporting event) or the theater and other comparable entertainment.

**.03 Obligations of Persons Associated with a Member.** Consistent with Rule 0140, persons associated with a member must comply with such member’s written policies and supervisory procedures as established pursuant to this Rule 3222. In addition, consistent with Rule 0140, it shall be a violation of this Rule for an associated person to engage in the conduct to be prevented (i.e., business entertainment that is intended as, or could reasonably be perceived as intended as, an improper quid pro quo) through the establishment, maintenance and enforcement of the policies and procedures required by this Rule.

### **3223. Exemptions**

Pursuant to the Rule 9600 Series, FINRA staff, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of the 3200 Series to the extent that such exemption is consistent with the purpose of the 3200 Series, the protection of investors, and the public interest.