

FINANCIAL INSTITUTIONS ADVISORY & FINANCIAL REGULATORY | August 16, 2016

FINRA Proposes Revisions to Gifts, Gratuities and Non-Cash Compensation Rules

On August 5, 2016, FINRA in Regulatory-Notice 16–29¹ proposed revisions to its regulation of broker-dealer gifts, entertainment and non-cash compensation (the “proposal”) and requested comments to the same. The comment period expires on September 23, 2016.

The proposal would consolidate FINRA’s regulation of gifts, gratuities and non-cash compensation into a single FINRA rule series; increase the current gift limit to \$175 per recipient, per year; amend FINRA’s non-cash compensation regulation to cover sales of all securities products; and consolidate certain interpretive guidance into the proposed rules, among other changes.² The proposal would amend FINRA Rule 3220 (the “Gifts Rule”) and create FINRA Rules 3221 (Non-Cash Compensation) and 3222 (Business Entertainment).

The Gifts Rule

Currently, the Gifts Rule prohibits any FINRA member or person associated with a member from giving anything of value in excess of \$100 per year to any person where such payment is connected with the business of the recipient’s employer. The rule requires that gifts by the member firm and all associated persons must be aggregated, and that records be maintained regarding all such gifts.

Under the proposed revision of the Gifts Rule, the \$100 limit would be increased to \$175 per recipient, per year. FINRA noted that the proposed increase takes into account the rate of inflation since the current limit was adopted in 1992.³

The revised Gifts Rule would also incorporate in Supplementary Materials the guidance of NASD Notice to Members 06–69 and of a 2007 FINRA interpretative letter regarding the application of the Gifts Rule to bereavement gifts.⁴ The Supplementary Materials would provide the following:

¹ See FINRA Regulatory-Notice 16-29 “Gifts, Gratuities and Non-Cash Compensation Rule” (August 2016), currently available at http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-29.pdf.

² For background regarding FINRA rulemaking regarding gifts and entertainment, please see our 2008 client publication “At the Close of the Investigation that Started It All, an Update on FINRA’s Gift and Entertainment Rulemaking,” available at <http://www.shearman.com/en/newsinsights/publications/2008/03/at-the-close-of-the-investigation-that-started-i>.

³ In 1992, the Securities and Exchange Commission (“SEC”) approved an increase of the limit from \$50 to \$100 per person per year, and previously, in 1984, from \$25 to \$50.

⁴ Letter from FINRA to SIFMA, dated December 17, 2007.

- *Gifts incidental to business entertainment.* Expressly states that there is no exclusion from the \$175/year limit for gifts given in the course of business entertainment, unless the gift is a gift of *de minimis* value or a promotional or commemorative item as those standards are set forth in the rule.
- *Valuation of gifts.* Gifts must be valued at the higher of cost or market value, exclusive of tax or delivery charges. Provides guidance for gifts given to multiple recipients.
- *Aggregation of gifts.* Members must aggregate all gifts given by the member and each associated person to a particular recipient over the course of the year.
- *Bereavement Gifts.* Bereavement gifts that are customary and reasonable are not considered to be in relation to the business of the recipient and accordingly are not subject to the \$175/year limit or to the rule's recordkeeping requirements.
- *Personal Gifts.* Gifts given for infrequent life events (e.g., a wedding gift or congratulatory gift for the birth or adoption of a child) are not subject to the \$175/year limit or to 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. In considering whether those standards are met, the Supplementary Material provides that members must consider the nature of any pre-existing personal or family relationship. When the member bears the cost of the gift, FINRA presumes that such gift is not personal in nature.
- *De Minimis and Promotional Items.* 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 the value of the gifts is below \$50.

Restrictions on Non-Cash Compensation

Current FINRA rules generally prohibit members and associated persons from directly or indirectly accepting or making payments or offers of non-cash compensation in connection with the sale of certain contracts and securities, including variable insurance contracts, investment company securities, Direct Participation Programs and public offerings of debt and equity securities.⁵

FINRA proposes to extend current restrictions on non-cash compensation to payments in connection with the sale of any security, and consolidate its non-cash compensation rules (currently found in Rules 2310, 2320, 2830 and 5110) into a single rule, numbered FINRA Rule 3221.

The prohibitions of the rule would incorporate exceptions contained in existing guidance, including with respect to:

⁵ See FINRA Rule 2320(g)(4) (Variable Contracts of an Insurance Company); NASD Rule 2830(l)(5) (Investment Company Securities); FINRA Rule 2310(c) (Direct Participation Programs); and FINRA Rule 5110(h) (Corporate Financing Rule – Underwriting Terms and Arrangements).

- Gifts from offerors⁶ that do not exceed a specified threshold (\$175/person/year) and are not preconditioned on the achievement of a sales target;
- Payments or reimbursements by an offeror of associated persons' expenses in connection with a training or education meeting held by an offeror or a member, provided that certain conditions are met; and
- 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 (a) the compensation is not preconditioned on achievement of a sales target, or (b) the compensation is preconditioned on achievement of a sales target, but the arrangement is (i) based on the total production of associated persons with respect to all securities distributed by a member, and (ii) not based on conditions that would encourage an associated person to recommend particular securities or categories of securities. Unlike the existing non-cash compensation rules, the proposal would not permit product-specific internal sales contests.

Also, proposed FINRA Rule 3221 would exclude from the rule's restrictions gifts of a de *minimis* value or a promotional or commemorative item.

Finally, the proposed rule would require firms to retain records of all non-cash compensation received or provided by the member or its associated persons.⁷

Business Entertainment

Existing FINRA guidance on business entertainment provides 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."⁸

Proposed FINRA Rule 3222 would consolidate FINRA's interpretive guidance regarding business entertainment into a single rule and require each member to adopt written policies and procedures relating to business entertainment tailored to its business needs under a principles-based approach.

Under proposed Rule 3222, those policies and procedures must:

- Be designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived as intended as, an improper *quid pro quo*;

⁶ "Offeror" is defined in section (a)(4) of proposed FINRA Rule 3221, and generally includes an issuer, sponsor, adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities, as well as other entities with respect to investment company securities and variable contracts.

⁷ Proposed FINRA Rule 3221 expands existing recordkeeping requirements. The existing non-cash compensation rules require members to maintain records of non-cash compensation received, but not provided, by a member or its associated persons.

⁸ See letter from NASD to T. Rowe Price Investment Services, Inc., dated June 10, 1999, currently available at <http://www.finra.org/industry/interpretive-letters/june-24-1999-1200am>.

- Define forms of permissible and impermissible business entertainment based on the location, nature, frequency and dollar amount of the business entertainment provided;
- Require that the offeror,⁹ member or one or more of the member's associated persons hosts the business entertainment;
- Specify that the business entertainment must not be preconditioned on the achievement of a sales target;
- Require appropriate training and education of all personnel who supervise, administer or are subject to the written policies and supervisory procedures; and
- Require the maintenance of detailed records of business entertainment expenses including certain required elements.

Comment Period

Comments must be received by FINRA by September 23, 2016. FINRA requested comments for all aspects on the proposal and on a number of specific questions, including with respect to:

- Whether the Gifts Rule should apply to gifts a member gives to its own employees or from a member firm's employee to his or her individual retail clients or customers;
- The appropriateness of the \$50 *de minimis* threshold in the Gifts Rule;
- How the consolidation of the rules governing gifts, gratuities and non-cash compensation would impact compliance and compliance costs.

⁹ Offeror in proposed Rule 3222 has the same meaning as in proposed Rule 3221, discussed above.

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