

MEMO# 30127

August 12, 2016

FINRA Proposes Changes to Its Non-Cash Compensation Rules; ICI Requests Members' Comments by August 26

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 27-16
PRINCIPAL UNDERWRITERS WORKING GROUP RE: FINRA PROPOSES CHANGES TO ITS NON-CASH COMPENSATION RULES; ICI REQUESTS MEMBERS' COMMENTS BY AUGUST 26

FINRA has published a notice seeking comment on amendments it proposes to its gifts, gratuities, and non-cash compensation rules. [\[1\]](#) As discussed in more detail below, this proposal is the result of a retrospective review of these rules FINRA began in 2014. Comments are due to FINRA no later than September 23, 2016. The Institute is planning to file a letter with FINRA supporting the proposal and raising any issues that warrant additional consideration or clarification. If there are any issues you recommend we include in our comment letter, please provide them to the undersigned no later than Friday, August 26th by phone (202-326-5825) or email (tamara@ici.org). FINRA's proposal, as well as the comments the Institute previously provided to FINRA as part of this initiative, are briefly summarized below.

Background

In April 2014, FINRA published a notice seeking comment on the effectiveness and efficiency of FINRA Rule 2830(I)(5) relating to non-cash compensation arrangements involving investment company securities. After getting input from members, the Institute filed a comment letter with FINRA that commended FINRA for undertaking its initiative and expressed concerns with provisions in the existing rule relating to: (1) the \$100 limit on nominal gifts (which was last established in 1998); (2) the ambiguities associated with the rule's exception for occasional meals, tickets, and entertainment; and (3) the treatment of "blended" events that include both training and entertainment. [\[2\]](#)

In addition to soliciting written comments, as part of this initiative, FINRA held meetings with interested persons (including the ICI) to discuss commenters' concerns in more detail and it conducted an electronic survey relating to issues raised by commenters. All of these activities were conducted during the review's "Assessment Phase." When it completed this phase, FINRA published a "Retrospective Rule Review Report," which summarized what

they learned during the Assessment Phase. [3] FINRA then transitioned to the “Action Phase,” which consists of FINRA publishing its current Notice seeking comment on proposed revisions to its existing rules.

FINRA’s Proposed Revisions

FINRA Rule 2830 governs investment company securities. Subsection (I) of the rule governs member compensation relating to investment company securities. Subdivision (I)(5) governs the receipt or payment of non-cash compensation. Its provisions address non-cash compensation in the form of: nominal (i.e., less than \$100) gifts; occasional meals, tickets, or entertainment; reimbursement of expenses for training or educational meetings; and sales contests. The rule also imposes recordkeeping requirements on FINRA’s members.

As noted above, the Institute’s 2014 comment letter to FINRA expressed concern with the rule’s \$100 de minimis limit on gifts and the treatment of non-cash compensation that involves entertainment or entertainment provided in conjunction with training or educational meetings. FINRA’s proposal appears to address these concerns. In addition, FINRA has determined to expand the scope of the its provisions relating to gifts, gratuities, and non-cash compensation to extend them to the offering of all securities and not just to investment company securities. As a result of this expansion, FINRA has proposed to adopt four new rules (along with related Supplementary Material) to govern all members’ non-cash compensation arrangements. These four rules are summarized below.

Rule 3220, Influencing or Rewarding Employees of Others

This new rule tracks the de minimis exemption of Rule 2830(I)(5)(A) but increases its amount from \$100 to \$175. It also includes Supplementary Material codifying previous NASD/FINRA guidance relating to (1) gifts incidental to business entertainment; (2) the valuation of gifts; (3) a requirement to aggregate gifts given over the course of a year; (4) the treatment of bereavement and personal gifts; (5) the treatment of promotional or commemorative gifts under the de minimis limit; and (6) supervisory and recordkeeping requirements. The Supplementary Material relating to recordkeeping clarifies, as recommended by the ICI, that gifts of de minimis value or that are nominal promotional or commemorative items “are not subject to the recordkeeping requirements” of the rule. Aside from expanding the rule’s scope to all FINRA members, increasing the rule’s de minimis amount, and providing a limited exception from the rule’s recordkeeping requirements, this new rule does not appear to make any substantive changes to what is currently provided in Rule 2830(I)(5)(A).

Rule 3221, Restrictions on Non-Cash Compensation

As with Rule 3220, this new rule’s application will not be limited to investment company securities. Its provisions largely track those of Rule 2830(I)(5)(C) relating to the payment or reimbursement by offerors in connection with training or education meetings. [4] Accordingly, its provisions govern: (1) de minimis gifts; (2) payment or reimbursement of training or educational expenses; and (3) sales contests. Added to the new rule are provisions that restrict the location of a training or educational meeting to an office in the United States. The new rule also clarifies that the reimbursement of expenses applies “only to training, education, meals, lodging, and transportation,” and cannot apply to the “entertainment or expenses of guests or associated persons or to the entertainment of associated persons.” [5]

With respect to the sales contest portion of the rule, the new rule differentiates non-cash

compensation that is “not preconditioned on the achievement of a sales target” from compensation that “is preconditioned on the achievement of a sales target.” While no conditions are imposed on the former, the latter includes the conditions currently in Rule 2830(l)(5)(D) but further adds that the sales target cannot be “based on conditions that would encourage an associated person to recommend particular securities or categories of securities.” According to the Notice, “internal sales contests that favor one security . . . or one type of security . . . 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.” [\[6\]](#)

Also added to the rule is a new section requiring that all contributions by a non-member company to a member’s cash compensation arrangements must meet the criteria of the rule’s sales contest provisions. Finally, Subsection (c) of the rule includes a recordkeeping requirement that is more detailed than that currently in Rule 2830(l)(5).

The new rule also includes Supplementary Material relating to: (1) gifts incidental to business entertainment; (2) the valuation of gifts; (3) the aggregation of gifts; (4) the treatment of personal gifts, de minimis gifts, and promotional or commemorative items; and (5) training or education meetings. With respect to (5), this Supplementary Material clarifies that any training or educational meetings “must first and foremost be intended to provide training or education” and “must occupy substantially all of the work day.” It also clarifies that, while payment for meals, lodging, and transportation is permissible, “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 entertainment is impermissible.” Also, any gifts given in connection with the training are subject to the rule’s prohibitions governing the giving of gifts. This Supplementary Material appears to address those concerns raised in the Institute’s 2014 letter to FINRA regarding confusion relating to the treatment of “blended” events.

Rule 3222, Business Entertainment

New Rule 3222 would govern members’ activities relating to business entertainment. As recommended by the Institute, this new rule is principles-based and, as a result, does not impose specific requirements or conditions governing members’ entertainment. Instead, it requires each member that engages in business entertainment to “have written policies and supervisory procedures” relating to business entertainment. These policies and procedures must:

1. 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;”
2. Define forms of permissible and impermissible business entertainment based on location, nature, frequency, dollar amount, accommodations, or transportation;
3. Require the offeror, member, or an associated person of the member to host the event;
4. Specify that the entertainment is not pre-conditioned on the achievement of a sales target;
5. Require appropriate training and education of all personnel who supervise, administer, or are subject to the written policies and supervisory procedures; and
6. Require the maintenance of detailed records that include information specified in the rule.

Supplementary Material to this new rule would clarify that the rule’s purpose is to govern

business entertainment given or accepted by a member or its associated persons and that business entertainment “includes, but is not limited to, an occasional meal, a ticket to an event (e.g., a sporting event) or the theater and other comparable entertainment.” It also requires associated persons of a member to comply with the member’s written policies and procedures under the rule.

Rule 3223, Exemptions

New Rule 3223 expressly provides FINRA discretion “for good cause shown after taking into consideration all relevant factors,” to grant an exemption, conditionally or unconditionally, from any provisions of the 3200 series rules. Such exemption must be consistent with the purpose of the rules, the protection of investors, and the public interest.

Tamara K. Salmon
Associate General Counsel

endnotes

[1] See Gifts, Gratuities, and Non-Cash Compensation Rules, FINRA Regulatory Notice 16-29 (August 2016) (the “Notice”), which is available at:

http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-29.pdf.

[2] See Letter from the undersigned to Marcia E. Asquith, Office of the Corporate Secretary, FINRA, dated May 23, 2014, commenting on FINRA Notice 14-15 (April 2014). See, also, Institute Memorandum [No. 28140](#) (May 23, 2014), which summarized the Institute’s comment letter and included a copy of it as an attachment.

[3] FINRA’s Retrospective Rule Review Report (December 2014) is available at:

<http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602010.pdf>.

[4] The new rule also includes the definitions from Rule 2830(b)(1) of “affiliated member,” “cash compensation,” “non-cash compensation,” and “offeror.” It also includes a new definition of “preconditioned on the achievement of a sales target,” which is consistent with the manner in which FINRA has previously construed this term. With respect to the definition of “offeror,” the new definition distinguishes between those offerors that offer and sell variable annuity contracts and those that do not. See proposed Rule 3221(a)(4).

[5] As such it addresses the Institute’s concern with the treatment of “blended” education/entertainment events. While educational events would be governed by Rule 3221, entertainment events would be governed by new Rule 3222.

[6] Notice at p. 6.