

MEMO# 28140

May 23, 2014

ICI Files Comment Letter on FINRA Review of its Non-Cash Compensation Rule

[28140]

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 26-14
PRINCIPAL UNDERWRITERS WORKING GROUP RE: ICI FILES COMMENT LETTER ON FINRA REVIEW OF ITS NON-CASH COMPENSATION RULE

As we previously informed you, [\[1\]](#) last month FINRA published a notice seeking comment on the effectiveness and efficiency of FINRA Rule 2830(l)(5), relating to non-cash compensation arrangements involving investment company securities. Comments are being requested as part of FINRA's retrospective review of its rules to determine whether they are meeting their intended investor-protection objectives by reasonably efficient means.

Subsequent to publication of the Notice, the Institute held a member call to solicit members' comments on the rule. Based on the input we received during that call, we prepared a draft comment letter, which was circulated to members for their feedback. [\[2\]](#) Based on the comments received, the Institute finalized the letter and filed it with FINRA. While the format of the letter we filed differs somewhat from the draft we previously circulated, with two minor exceptions, the substance of the filed letter is identical to that of the draft. The two minor exceptions, which were suggested by members, related to FINRA clarifying the treatment of raffles and charitable contributions under the rule. These issues are discussed in Section III.D. of the letter. The Institute's letter is briefly summarized below.

Summary of the ICI Letter

The Institute's letter commends FINRA for considering its non-cash compensation rule as part of its retrospective rule review. It notes that the rule, which was originally adopted in 1998, has not been substantively revised since its adoption. The letter also notes that the original purpose of the rule was two-fold: (1) to protect investors at the point-of-sale from undue influence resulting from non-cash compensation; and (2) to protect members' supervisory control over sales practices. To address these concerns, the rule established very particular guidelines regarding when and how non-cash compensation may be paid to

or received by FINRA member firms and their associated persons.

The Institute's letter discusses three exceptions in the rule that permit the payment of non-cash compensation subject to certain restrictions. These are the exceptions for: nominal gifts (Rule 2830(l)(5)(A)); occasional meals, tickets, and entertainment (Rule 2830(l)(5)(B)); and training and educational events (Rule 2830(l)(5)(C)). With respect to the first, the letter recommends that the rule be revised to require FINRA, no less frequently than every five years, to adjust the rule's de minimis gift amount. The letter notes that the current amount (\$100) was last established in 1998 and, had it been adjusted to reflect inflation, today such amount would be closer to \$170.

With respect to the rule's exception for occasional meals, tickets, and entertainment, the letter discusses the ambiguities associated with this exception, which result from the lack of clearly defined standards. It notes that these ambiguities present compliance challenges for our members that must deal with a variety of broker-dealers throughout the United States that may interpret the rule's requirements very differently. These different interpretations may vary among the type of broker-dealer (e.g., wirehouse, platform, retail) and whether the broker-dealer is a national, regional, or local firm. It discusses the confusion that results from the rule requiring members to categorize events that involve a blending of social events with training events, and from the FINRA's exception for prospecting trips.

The concerns we raise with "blended" events are also discussed under our comments on the training or education exception in the rule. [\[3\]](#) The letter discusses how the rule blurs and confuses the lines between non-cash compensation paid for entertainment, road trips, and training and education with respect to blended events, multi-sponsor events, and meals and drinks provided for certain attendees at an event.

The letter questions whether the rule's required categorization of non-cash compensation in these areas is necessary in light of reforms to other FINRA rules in the years since Rule 2830(l)(5) was adopted. These rules include more rigorous supervisory and suitability rules. The letter notes that these other rules may suffice to address the concerns that led to the original adoption of Rule 2830(l)(5) in 1998. In lieu of the current rule's structure, the letter recommends that FINRA consider replacing Subdivisions (l)(5)(B) and (C), governing entertainment and training and educational events, with a principles-based provision that does not require members to categorize their non-cash compensation expenditures. A principles-based approach could instead require a member to have policies and procedures relating to their payment of non-cash compensation, which are reasonably designed to avoid: (1) improperly influencing a broker-dealer or its associated person at the point of sale; (2) conflicts of interest that might impact recommendations by the broker-dealer or its associated persons; and (3) any conduct that might have the potential for undermining a member's supervisory controls of the member firm with respect to its associated persons. While the letter expressly states that we are not advocating that FINRA adopt a rule that contains each of these elements, we believe that, as part of FINRA's retrospective rule review, it explore alternatives to the categorization required by the current rule. In the event that FINRA determines to maintain the current structure of its rule, we recommend that it clarify the provisions in the rule that currently present compliance challenges to members.

A copy of the Institute's letter is attached.

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[Attachment](#)

endnotes

[1] See Institute [Memorandum](#) No. 28051 (April 21, 2014), which summarizes FINRA Notice 14-15 (April 2014) (the “Notice”), in which FINRA requests comment on the effectiveness and efficiency of its non-cash compensation rules as part of its retrospective rule project.

[2] See Institute [Memorandum](#) No. 28105 (May 8, 2014), which summarized and sought feedback on the Institute’s draft comment letter. A copy of the draft letter was attached to the memorandum.

[3] In addition to discussing issues relating to “blended” events, the letter recommends that FINRA reconsider the condition in the rule that prohibits reimbursement of “guest” expenses. It notes that, while we presume that this condition may have been intended to avoid paying the expenses of family members accompanying an associated person to an event, our members report that, today, it is not uncommon for the “guest” to be a financial professional, attorney, or accountant that works with the member or their clients to advise clients on financial matters. As such, it seems wholly appropriate to enable a member to reimburse the expenses of such persons. As part of its retrospective rule review, we recommend that FINRA consider revising the rule’s prohibitions to accommodate such reimbursement as a legitimate educational expense.

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