

MEMO# 19777

February 24, 2006

Institute Letter on NASD Proposal Relating to Business Entertainment Expenses

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19777] February 24, 2006 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 8-06 EQUITY MARKETS ADVISORY COMMITTEE No. 6-06 INVESTMENT ADVISER MEMBERS No. 9-06 COMPLIANCE MEMBERS No. 12-06 SEC RULES MEMBERS No. 21-06 SMALL FUNDS MEMBERS No. 17-06 RE: INSTITUTE LETTER ON NASD PROPOSAL RELATING TO BUSINESS ENTERTAINMENT EXPENSES The Institute has filed a comment letter with NASD on proposed Interpretive Material ("IM") to NASD Rule 3060 addressing business entertainment practices of member firms. The most significant aspects of the comment letter are summarized below and a copy of the letter is attached.

Proposed IM's Applicability to Mutual Fund Distributors and Wholesalers The letter states that it is unclear whether NASD intends for the proposed IM to cover situations involving business entertainment expenses related to the sale and distribution of investment company securities already covered under NASD Rule 2830. The letter states that applying the proposed IM to such situations would create overlapping and, to an extent, inconsistent regulation of member firms' business entertainment practices. This, in turn, could lead to confusion on the part of NASD members subject to Rule 2830 and interfere with members' efforts to ensure compliance with the terms and conditions of the rule. The letter notes that although both rules (and interpretations of those rules) use similar language to delineate when business entertainment would be permitted, the proposed IM appears to be designed to address situations distinct from those governed by Rule 2830. For these reasons, the letter recommends that NASD clarify that the proposed IM does not address situations already covered under Rule 2830 and does not supersede any interpretive guidance under that rule.

2 Clarification of Proposed Policies and Procedures The letter provides several technical comments on the proposed IM and requests further NASD guidance in several areas of the proposed policies and procedures.

- **Monitoring of Compliance with Policies and Procedures:** The proposed IM states that there should be periodic monitoring of compliance with the policies and procedures and that, when practicable, such monitoring should be conducted by an "independent reviewer." The letter recommends that NASD clarify that personnel within a member firm are eligible to conduct the independent review and that a member be provided with flexibility to determine when a review may be necessary and how often such a review should occur.
- **Personnel Designated to Supervise, Approve and Document Expenses:** The proposed IM states that members' policies and procedures must "establish standards to ensure that persons designated to supervise, approve and document business entertainment expenses are sufficiently qualified." The letter

recommends that NASD provide more specific guidance on factors that should be considered in determining whether such persons are sufficiently qualified and clarify that members have sufficient flexibility in applying those factors. • Recordkeeping Requirements: The proposed IM requires that members maintain “detailed” records of the nature and expense of business entertainment but is unclear as to what such “detailed” records would include. The letter recommends that the NASD provide guidance on the scope of records necessary under this requirement. • Training and Education of Personnel: The proposed IM requires that members have written policies and procedures that, among other things, “require appropriate training and education to all applicable personnel.” The Notice to Members describing the proposed IM states that members “should oversee the training and education of all personnel.” Given the inconsistency in this language, the letter requests that NASD clarify that this requirement relates only to “applicable” personnel, e.g., those personnel whose positions involve business entertainment expenses. Ari Burstein Associate Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 19777, or call the ICI Library at (202) 326-8304 and request the attachment for memo 19777. 3