

**MEMO# 19628**

January 25, 2006

## **NASD PROPOSAL RELATING TO GIFTS AND BUSINESS ENTERTAINMENT**

©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. [19628] January 25, 2006 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 4-06 EQUITY MARKETS ADVISORY COMMITTEE No. 4-06 INVESTMENT ADVISER MEMBERS No. 6-06 COMPLIANCE MEMBERS No. 7-06 SEC RULES MEMBERS No. 11-06 SMALL FUNDS MEMBERS No. 9-06 RE: NASD PROPOSAL RELATING TO GIFTS AND BUSINESS ENTERTAINMENT The NASD has issued a Notice to Members requesting comment on proposed Interpretive Material ("IM") to NASD Rule 3060 addressing gifts and business entertainment.<sup>1</sup> The proposed IM outlines the policies and procedures an NASD member must adopt in connection with its business entertainment practices with employees of a customer. It would supersede prior NASD staff guidance in this area. Rule 3060 prohibits any NASD 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. In 1999, the NASD issued a staff letter clarifying that Rule 3060 does not prohibit "ordinary and usual business entertainment" provided that such entertainment is "neither so frequent nor so extensive as to raise any question of propriety." The proposed IM provides guidance concerning the written policies and procedures that NASD members must adopt surrounding their business entertainment practices. Most significantly, an NASD member must determine and define the forms of business entertainment that are appropriate and inappropriate, including appropriate venues, nature, frequency, types and class of accommodation and transportation, and either firm dollar limits or thresholds requiring advance written approval. The proposed IM does not impose specific limits, nor does it require that all NASD members adopt the same limits or treat all recipients equally. At the same time, however, the Notice states that a member's policies and procedures must not be so unbounded or vague that no reasonable determination of propriety can be discerned. In addition, the proposed IM expressly would allow members to set different standards for 1 NASD Notice to Members 06-06 (January 2006) ("Notice"). The Notice can be found on the NASD's website at [http://www.nasd.com/web/groups/rules\\_regs/documents/notice\\_to\\_members/nasdw\\_015876.pdf](http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_015876.pdf). Comments on the proposal are due to the NASD no later than February 23, 2006. 2 business entertainment in connection with events that are educational, charitable or philanthropic in nature. The proposed IM also would require that an NASD member's policies and procedures preclude providing business entertainment that is so lavish or extensive in nature that an employee would likely feel compelled to act in a manner inconsistent with the interests of his or her employer (e.g., directing order flow without due regard to best execution or other transaction pricing considerations). In addition, NASD

members must maintain detailed records of business entertainment expenses and make such information available to the customer in respect of its employees upon written request. Finally, written policies and procedures must provide for effective supervision and compliance with a member's business entertainment policies. The proposed IM defines the terms "customer" and "business entertainment" for purposes of the IM. According to the Notice, the definition of "customer" recognizes the proposed distinction between business entertainment provided directly to natural person customers (which is not covered by Rule 3060) and business entertainment provided to employees, agents or representatives of a customer (which is covered by Rule 3060).<sup>2</sup> The definition of "business entertainment" codifies NASD's position that a member must accompany or participate in an event for it to be deemed business entertainment.<sup>3</sup> Ari Burstein Associate Counsel 2 "Customer" would be defined as a "person that maintains or whose employee receives business entertainment for the purpose of having such person prospectively maintain, an account with a member or is otherwise a customer of the member for the purpose of investment banking or securities business, and has an employee, agent or representative act on behalf of the account in some capacity in respect of such account or customer relationship with the member." 3 "Business entertainment" would be defined as entertainment "in the form of any social event, hospitality event, charitable event, sporting event, entertainment event, meal, leisure activity or event of like nature or purpose, as well as any transportation and/or lodging accompanying or related to such activity or event, including such business entertainment offered in connection with an educational event or business conference, in which a person associated with a member accompanies and participates with such employee irrespective of whether any business is conducted during, or is considered attendant to, such event."