

**MEMO# 19755**

February 17, 2006

## **Draft Institute Letter on NASD Proposal Relating to 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. [19755] February 17, 2006 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 5-06 EQUITY MARKETS ADVISORY COMMITTEE No. 5-06 INVESTMENT ADVISERS COMMITTEE No. 2-06 COMPLIANCE ADVISORY COMMITTEE No. 7-06 SEC RULES COMMITTEE No. 10-06 SMALL FUNDS COMMITTEE No. 5-06 RE: DRAFT INSTITUTE LETTER ON NASD PROPOSAL RELATING TO BUSINESS ENTERTAINMENT As we previously informed you,\* the NASD has issued a Notice to Members requesting comment on proposed Interpretive Material ("IM") to NASD Rule 3060 addressing gifts and business entertainment. The Institute has prepared a draft comment letter on the proposed IM. A copy of the draft letter is attached and the most significant aspects of the letter are summarized below. Comments on the proposed IM are due to the NASD no later than February 23, 2006. If you have any comments on the Institute's draft letter, please contact Ari Burstein by phone at 202-371-5408 or by e-mail at [aburstein@ici.org](mailto:aburstein@ici.org) no later than February 22. Proposed IM's Applicability to Mutual Fund Wholesalers and Distributors The draft letter states that it is unclear from the proposed IM and accompanying Notice to Members whether the NASD intends for the proposed IM to cover situations involving 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 business entertainment. This, in turn, could lead to confusion on the part of NASD members subject to Rule 2830. The letter notes that although both rules (and interpretations of those rules) use similar language to delineate when business entertainment would be permitted, it \* Memorandum 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 and Small Funds Members No. 9-06, dated January 25, 2006 [19628]. 2 appears that the proposed IM is designed to address situations distinct from those governed by Rule 2830. For these reasons, the draft 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. Clarification of Proposed Policies and Procedures The draft letter provides several technical comments on the proposed IM and requests NASD guidance in several areas of the proposed policies and procedures, including: • 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 draft letter recommends that the NASD clarify that personnel within a member firm are permitted to conduct such an 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 draft letter recommends that the NASD provide guidance on factors that should be considered in determining whether such persons are sufficiently qualified and clarify that members will be provided with flexibility in applying those factors. • Recordkeeping Requirements: The proposed IM requires that members must maintain "detailed" records of the nature and expense of business entertainment but is unclear what such "detailed" records would include. The draft letter recommends that the NASD provide guidance on the scope of records necessary under this requirement. Ari Burstein Associate Counsel Attachment (in .pdf format)

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