

Chapman Client Alert

August 29, 2016

Current Issues Relevant to Our Clients

FINRA Proposes Changes to Its Gifts, Non-Cash Compensation and Business Entertainment Rules

The Financial Industry Regulatory Authority, Inc. (“*FINRA*”) recently proposed amendments to its gifts, non-cash compensation and business entertainment rules that would, if adopted:

- consolidate these rules under a single set of FINRA rules,
- increase the gift limit from \$100 to \$175 per person per year and include a *de minimis* threshold below which firms would not have to keep records of gifts given or received,
- establish a new FINRA rule related to non-cash compensation applicable to sales of all securities (subject to specified exceptions) and including certain new limitations and recordkeeping requirements,
- establish a new FINRA rule that would require firms to adopt written policies and supervisory procedures related to business entertainment, and
- incorporate existing FINRA guidance and interpretive positions into the FINRA rules and supplementary materials.

The FINRA Regulatory Notice seeking comment is available [here](#).

Amendments to Gift Rule (FINRA Rule 3220)

Currently, Rule 3220 prohibits any member or person associated with a member from, directly or indirectly, giving or permitting to be given anything of value in excess of \$100 per person per year where the payment relates to the business of the recipient’s employer. The proposed rule changes would amend Rule 3220 to increase this limit to \$175 per person per year. The proposed amendments would also incorporate existing guidance and interpretive positions, such as the aggregation, valuation and supervision requirements that are currently set forth in other FINRA guidance. The new Supplementary Material to Rule 3220 would state that, among other things:

- there is no express exclusion from Rule 3220 for gifts given during the course of business entertainment, unless the gift is of *de minimis* value, or a promotional or commemorative item,
- gifts must be valued at the higher of cost or market value,
- FINRA members must aggregate all gifts given by the member and each associated person of the member to a particular recipient over the course of the year for purposes of the \$175 limit,
- bereavement gifts that are customary and reasonable are not considered to be in relation to the business of the employer of the recipient and, therefore, are not subject to the restrictions of Rule 3220 or its recordkeeping requirements,
- gifts given for infrequent life events (*e.g.*, a wedding gift or congratulatory gift for the birth of a child) are not subject to the restrictions of Rule 3220 or its recordkeeping requirements provided the gifts are customary and reasonable, personal in nature and not related to the business of the employer of the recipient, and
- gifts of a *de minimis* value, promotional items of nominal value and commemorative items are not subject to the restrictions of Rule 3220 or its recordkeeping requirements provided they meet certain specified conditions.

Additionally, FINRA is proposing to codify existing guidance requiring firms to have a supervisory and recordkeeping system in place reasonably designed to achieve compliance with Rule 3220.

Proposed Non-Cash Compensation Rule (FINRA Rule 3221)

Current FINRA rules generally prohibit members and their associated persons from, directly or indirectly, accepting or making payments or offers of non-cash compensation in connection with the sale of variable insurance contracts, investment company securities, direct participation programs and the public offerings of debt and equity securities, subject to specified exceptions. Proposed Rule 3221 would expand this prohibition on non-cash compensation in connection with the sale of **any** security subject to certain exceptions.

Exception for Certain Gifts from Offerors. The proposed rule would include the existing exception for non-cash gifts from offerors that do not exceed a specified threshold per person per year and are not preconditioned on the achievement of a sales target, but increase the threshold amount from \$100 to \$175 consistent with the changes to Rule 3220.

Exception for Training or Educational Meetings. The proposed rule would permit an offeror to make payments or reimbursements of associated persons' expenses in connection with a training or educational meeting held by an offeror or a FINRA member, provided that the meeting meets the following conditions:

- Associated persons must obtain the member's prior approval to attend the meeting and attendance, as well as the payment or reimbursement by the offeror, must not be preconditioned on the achievement of a sales target.
- The location must be appropriate to the purpose of the meeting. Appropriate locations under the proposal would generally include a U.S. office of the offeror or member holding the meeting, a facility located in the vicinity of such office, or a U.S. regional location with respect to meetings of associated persons who work within that region.
- Payment or reimbursement by the offeror must apply only to the training, education, meals, lodging and transportation for associated persons. The proposed rule would make clear that the offeror could not pay or provide reimbursement for the entertainment or expenses of guests of associated persons or for the entertainment of associated persons.

Exception for Internal Sales Contests. Proposed Rule 3221 would also continue to permit non-cash compensation arrangements related to internal sales contests but would change some of the existing requirements. Under the proposed rule, any non-cash compensation arrangement must either:

- not be preconditioned on the achievement of a sales target, or
- if it is preconditioned on the achievement of a sales target, the non-cash compensation arrangement must (1) be based on the total production of associated persons with respect to all securities distributed by the member and (2) not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities.

Contributions meeting the above criteria would also be excepted where made by (1) a non-member company or other member to a non-cash compensation arrangement between a member and its associated person or (2) a member to a non-cash compensation arrangement of a non-member. Unlike the existing non-cash compensation rules, the proposal would not permit product-specific internal sales contests. Consequently, "stock of the day" and similar promotions would be impermissible under the proposal.

Incorporation of Existing Guidance and Interpretive Positions. Proposed Rule 3221 also includes Supplementary Material similar to that included with the Supplementary Material to the Rule 3220 related to gifts. The proposed Supplementary Material for Rule 3221 would also incorporate prior FINRA guidance regarding training or education meetings. Specifically, the Supplementary Material would provide that:

- the proposed rule's training or education exception must first and foremost be intended to provide training or education to an associated person,
- any training must occupy substantially all of the work day, and
- payment or reimbursement for any related meals, lodging and transportation is permissible, but 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 education is impermissible.

Recordkeeping. The proposal would also require members to retain records of non-cash compensation received or provided by a member **or** its associated person. This is different than the existing non-cash compensation rules which only require members to retain records related to non-cash compensation received by it or its associated person.

Proposed Business Entertainment Rule (FINRA Rule 3222)

Under current FINRA guidance, ordinary and usual business entertainment is not prohibited provided that the entertainment is neither so frequent nor so extensive as to raise any question of propriety. Proposed Rule 3222 would replace this standard with a principles-based approach requiring firms to adopt written policies and supervisory procedures that, among other things:

- are designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived as intended as, an improper *quid pro quo*,
- define forms of permissible and impermissible business entertainment based on the location, nature, frequency and dollar amount of the business entertainment provided, as well as the type and dollar amount of any accommodations or transportation provided in connection with such business entertainment,
- require that the offeror, member or one or more of the member's associated persons hosts the business entertainment,
- specify that the business entertainment must not be preconditioned on the achievement of a sales target, and

- require appropriate training and education of all personnel who supervise, administer or are subject to the written policies and supervisory procedures.

The proposed rule would also require each member to maintain detailed records of business entertainment expenses including:

- the names of all persons providing and receiving business entertainment,
- the location, nature, frequency and dollar amount of the business entertainment, and
- the type and dollar amount of any accommodations or transportation provided.

What's Next?

FINRA is seeking general comments on the rule proposals and soliciting responses to a specific list of questions set forth in the Regulatory Notice. Comments are due by September 23, 2016 and may be submitted by physical mail or by email to pubcom@finra.org. Firms should also review the proposals and consider how they may impact existing practices.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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