INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

September 22, 2016

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street NW
Washington, DC 20006-1506

Re: Proposed FINRA Rules 3220, 3221, and 3222 Relating to Gifts, Gratuities and Non-Cash Compensation

Dear Ms. Asquith:

The Investment Company Institute[1] is writing in response to FINRA's request for comment on its proposal to amend FINRA Rule 3220 (Influencing or Rewarding Employees of Others) and to adopt new Rules 3221 (Restrictions on Non-Cash Compensation) and 3222 (Business Entertainment).[2] This proposal results from FINRA's retrospective review of its regulation of members' non-cash compensation arrangements, which it began in 2014. In addition to supporting adoption of these rules and rule amendments, the Institute commends FINRA for conducting its retrospective rule review and for proposing amendments to address concerns identified during it.

As it noted when it began its review, FINRA was interested in determining the effectiveness of its non-cash compensation rule. FINRA also was interested in understanding members' experiences with the rule, including any ambiguities or compliance challenges. To obtain meaningful input to assist

[1] The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $18.4 trillion and serve more than 90 million U.S. shareholders.

[2] *See Gifts, Gratuities and Non-Cash Compensation Rules,* FINRA Regulatory Notice 16-29 (August 2016).

its review, FINRA published a notice seeking comment on its current rule.[3] It supplemented the written comments it received[4] by conducting a survey of its members to get their views on the rule and holding meetings with interested persons, including the Institute, to discuss ways to reform the rule. We greatly appreciate the extent of FINRA's outreach in conducting its retrospective rule review and, as stated above, we support the proposed revisions that resulted from this process.

Notwithstanding our support for adoption of FINRA's proposal, we provide below several comments and recommendations to better clarify some of its provisions.

I. RULE 3221, RESTRICTIONS ON NON-CASH COMPENSATION

FINRA's proposal, in part, will better distinguish those provisions that govern non-cash compensation relating to non-business entertainment (including compensation relating to training and educational events) from that relating to business entertainment. As proposed, new Rule 3221 will govern the former. The Institute supports FINRA addressing these arrangements through separate rules because we believe it will provide greater clarity regarding which FINRA rule governs which type of event. The Institute's comment letter had recommended that FINRA address the uncertainty under its current rule and we are pleased that it has done so. We also are pleased that FINRA is proposing to extend the scope of its regulation of non-cash compensation arrangements, which currently apply only to investment company securities, to all offerings of securities. We concur with FINRA that the conflicts underlying the rule's prohibitions exist with respect to all securities.

While we support FINRA adopting Rule 3221 to govern non-cash compensation arrangements relating to non-business entertainment events, we recommend two revisions to the portion of the rule that addresses training or education meetings. The first recommendation relates to the provision in subdivision (b)(2)(B) that requires the meeting location to be an appropriate location, which is defined to mean an "office of the offeror or the member holding the meeting, or a facility located in the vicinity of such office." We note that it is not uncommon for our members, as offerors, to pay or reimburse the expenses of associated persons related to attending an industry training or educational conference that is not sponsored by the offeror or the member (*e.g.,* an ICI or Morningstar conference). Because these conferences are not sponsored by an offeror or member, they likely may not be held in an appropriate

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[3] *See FINRA Requests Comment on the Effectiveness and Efficiency of its Gifts and Gratuities and Non-Cash Compensation Rules,* FINRA Notice 14-15 (April 2014).

[4] In response to FINRA's request for comment, the Institute filed a comment letter that focused on those provisions in the rule that our members found to be ambiguous and that, therefore, challenged their compliance efforts. In addition to pointing out these ambiguities and challenges, our letter advocated that, in revising the rule, FINRA explore adopting a principles-based approach to regulate members' non-cash compensation arrangements. *See* Letter from the undersigned to Marcia E. Asquith, Office of the Corporate Secretary, FINRA, dated May 23, 2014, which was filed in response to FINRA Notice 14-15.

location as defined in subdivision (b)(2)(B). We recommend that FINRA accommodate, either in the rule or in Supplementary Material, offerors' and members' support of associated persons' attendance at such conferences without running afoul of subdivision (b)(2)(B) of the rule because of the location of the conference. We believe this accommodation is appropriate due to the training or educational value provided to members and their associated persons by these conferences.

Our second recommendation relates to subdivision (b)(2)(C) of the rule. We recommend that FINRA delete the language in the provision relating "to the entertainment or expenses of guests of associated persons or to the entertainment of associated persons." We believe that including this provision in this rule will again lead to uncertainty regarding whether events fall under Rule 3221 or under new Rule 3222, which governs business entertainment expenses. To avoid this uncertainty, we recommend that this phrase be moved from Rule 3221 to Rule 3222. By doing so, Rule 3222 will address all issues relating to the entertainment expenses of associated persons and their guests[5].

We additionally recommend that FINRA clarify, either in the rule or in guidance or interpretive material relating to the rule, the treatment of member events that involve separate training and entertainment components (*e.g.*, if the member has a training event during the day and an entertainment event that evening). We recommend that FINRA clarify that, for such events, the training component must satisfy the requirements of Rule 3221 (and its Supplementary Material) while the entertainment component must comply with the policies and procedures the member has adopted pursuant to Rule 3222.

II. RULE 3221, SUPPLEMENTARY MATERIAL .06, TRAINING OR EDUCATION MEETINGS

As proposed, Rule 3221 would include Supplementary Material .06 to clarify the conditions a training or educational event must satisfy to qualify for the exemption in proposed Rule 3221(b). We support this Supplementary Material because we believe the additional guidance will benefit members' compliance efforts. We recommend, however, that FINRA revise this Supplementary Material to address the treatment of those educational events that do not "occupy substantially all of the work day." For example, if a member hosts an educational event over breakfast or a "lunch and learn" event in which the member provides an educational seminar over breakfast or lunch, such events would not qualify for the training exception of Rule 3221(b) because they do not occupy substantially all of the work day. And yet, because of associated persons' time constraints during a business day, it is not uncommon for an educational session to be held over breakfast or lunch. Just because the training event is limited in duration and held over a meal, we do not believe the rule should preclude the event from qualifying as a training or educational event; nor do we believe that associated persons attending these events should be required to pay for their lunch or breakfast in order to comply with FINRA's

[5] In our view, this recommendation is technical in nature and will not impact FINRA's interest in ensuring that non-cash compensation paid in connection with training or educational events cannot be used to pay for or reimburse entertainment expenses.

rule. The *de minimis* nature of the meal provided during these events would not appear to raise the conflicts FINRA seeks to address through the rule's conditions and prohibitions. Accordingly, we recommend that FINRA revise Supplementary Material .06 to permit members to accept a meal associated with a training event even when such event does not occupy substantially all of the work day.

III. RULE 3222, BUSINESS ENTERTAINMENT

The Institute is very pleased to see FINRA propose a new separate rule dedicated to compensation relating to business entertainment. We also are pleased that this new rule takes a principles-based approach to regulating members' business entertainment arrangements. In our view, this approach will enable members to adopt policies and procedures tailored to their circumstances, thereby avoiding a "one-size-fits-all" approach that fails to take into account the member's location, the nature of their business, the necessary frequency of their events, and the dollar amount associated with particular business events. As such, the rule will provide greater flexibility to members while, at the same time, avoiding even the appearance of conflicts of interests that those events may raise. The Institute's comment letter had supported a principles-based approach to entertainment expenses, and we commend FINRA for proposing a principles-based rule.

A. Reasonably Designed Policies and Procedures

As proposed, Rule 3222 will require each member that engages in business entertainment to have written policies and procedures governing their business entertainment activities. Among other things, these policies must be "designed to detect and prevent" certain prohibited business entertainment. The Institute recommends that this clause be revised in relevant part to read: "(1) Are reasonably designed to detect and prevent . . .." This change, which imposes an objective standard by which FINRA can assess the member's policies and procedures, is consistent with the standard contained in other FINRA rules.[6]

B. Quid Pro Quo As a Standard

We also recommend that FINRA reconsider the rule's proposed quid pro quo standard. In part, Rule 3222 will replace the current standard by which entertainment events are judged with a new standard. While the current rule prohibits entertainment events that are "so frequent" or "extensive as to raise any question of propriety," Rule 3222 would replace this standard with a "quid pro quo" standard in which events are judged based on whether they are intended to result in quid pro quo. We support FINRA including a standard in the new rule. We are concerned, however, that the rule will

[6] *See, e.g.,* FINRA Rule 3130(b), relating to the annual certification of the member's compliance policies and procedures, which requires the member to certify, in part, that its policies and procedures are "reasonably designed to achieve compliance with applicable FINRA rules . . .."

require FINRA to prove that business entertainment was intended to result in quid pro quo in order to sanction a member for violating the rule. This evidentiary standard would appear to require FINRA to connect an entertainment event with specific quid pro quo (or intended quid pro quo), which might prove difficult.

To avoid these evidentiary challenges, we recommend that FINRA utilize a different standard that both addresses the concerns underlying this rule and eliminates the need for FINRA to prove a clear nexus between an event and any intended quid pro quo. In particular, we recommend that FINRA require a member's policies and procedures under the rule to be reasonably designed to detect and prevent business entertainment that is intended as, or could reasonably be perceived as intended as, "improperly interfering with a member's suitability obligations under Rule 2111." We believe this in an appropriate standard because the conflicts of interest that would arise from business entertainment are those that would result in the member subordinating its customers' interest to those of the member – which would arise in connection with the member's recommendations to its customers. Violations of this new standard would appear easier for FINRA to prove because, instead of having to prove intended quid pro quo, FINRA would only need to prove that a member is making recommendations either before an anticipated entertainment event or following the event that seem to advantage the sale of securities offered by the sponsor of the event. Accordingly, we believe this standard would better address the concerns underlying the proposed rule and better enable FINRA to prove violations of the rule.

C. Guests' Entertainment Expenses

As proposed, Rule 3222 is silent on whether the entertainment expenses of guests must be addressed in a member's policies and procedures under the rule. It appears that the only mention of expenses associated with "guests of associated persons" appears in Rule 3221(b)(2)(C), relating to the payment or reimbursement of training expenses. As noted above, the Institute recommends that FINRA move any provisions relating to entertainment from Rule 3221 to Rule 3222. In addition, however, we recommend that FINRA revise Rule 3222 to expressly require that a member's written policies and supervisory procedures under the rule address the entertainment expenses of an associated person's guests, subject to the same conditions and standards set forth in the rule for the entertainment expenses of the member or its associated persons.

IV. RULE 2341(l)(5)

FINRA's proposed rules would update and modernize FINRA's existing rule, Rule 2341(l)(5), which currently governs members' non-cash compensation arrangements. Though not expressly mentioned in FINRA's Notice, we presume that FINRA intends to delete Rule 2341(l)(5) as part of this initiative. We support eliminating this rule to avoid any inconsistency between FINRA's current rule and the new rules.

We again commend FINRA for its thoroughness in conducting its retrospective review of its non-cash compensation rule and we appreciate all the ways in which FINRA engaged with its members and interested persons during its multi-year review. The resulting proposal evidences the care with which FINRA went about this process and, in our view, addresses those issues with the current rule that are of concern to our members. We support adoption of FINRA's proposed rules. If you have any questions regarding our comments, please contact the undersigned by phone (202-326-5825) or email (tamara@ici.org).

Regards,

/s/ Tamara K. Salmon

Tamara K. Salmon
Associate General Counsel

Cc: Joseph Savage, Vice President and Counsel, Regulatory Policy