



By Electronic Mail

February 23, 2006

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1506

Re: Notice to Members 06-06 – Gifts and Business Entertainment

Dear Ms. Sweeney:

Thank you for giving us the opportunity to comment on the proposed interpretative material (IM) to Rule 3060 as described in Notice to Members 06-06 (NTM).

We understand NASD's regulatory concerns over gifts and gratuities in general. We believe, however, that any proposed rule change that would impose substantial burdens on the industry must be based on a clearly articulated need for such a rule change and that the resultant burdens on the industry must be substantially outweighed by the public interest. This is particularly true where, as here, the proposed rule would operate to the possible benefit of only a small segment of the investing public.

We respectfully submit that the proposed IM is not accompanied by an appropriate, articulated need and that, as set forth below, it contains requirements that are unduly vague and virtually impossible to comply with. We further submit that the proposed IM is, in effect, a rule change that should be made through the rulemaking process and not by an interpretation of the NASD Board of Governors.

The Proposed IM Inappropriately Imposes New Rule Requirements

The proposed IM fundamentally changes the meaning of current Rule 3060 without any explanation of how that change is reasonably and fairly implied by the rule.

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Rule 3060 currently prohibits gifts and gratuities where such payment is “in relation to the business of the recipient’s employer.” Under Rule 3060, the NASD has the burden of showing that where a gift is made to a person who is also an employee of an entity, the gift is directly related to the business of the recipient’s employer in order to establish a violation of Rule 3060.¹ Under the proposed IM, the NASD shifts the burden of proof to member firms by imposing a standard that a gift would violate Rule 2110 if it could be “reasonably judged to have the like effect of causing, such employee to act in a manner that is inconsistent with the best interests of the customer.” This shift in the burden of proof is particularly disturbing when done through an IM interpreting Rule 2110 rather than a rule proposal. In this context, there is no hint of the statutory basis for the IM, or whether it presents an unfair burden on competition.

Further, under the proposed IM, *anything of value* to any “employee” would be prohibited if it would “likely” have the effect of causing the employee to act against the best interests of the employer. The proposed IM would apparently include in the definition of “customer” virtually any kind of entity that currently has or might in the future have an account with the member and an “employee” as any person who has any relationship with the “customer.” The proposed IM, as currently drafted, does not limit the definition of “employee” to only those persons who have control over the account of the customer. Thus, any person who is employed by any entity that may now or in the future have an account with a broker-dealer would be considered an “employee” under the interpretation. However, current Rule 3060 prohibits gifts and gratuities *in excess of \$100 given in relation to the business of the employer*. Thus the interpretation, by leaving out such important language, inappropriately expands the reach of Rule 3060 through an interpretation of Rule 2110.²

Additionally, the stated standards are unduly vague. First, it is not clear whose “judgment” is to be used in determining whether a gift is inappropriate. There is no “reasonable person” standard in the proposal and it is not clear whether it is the judgment of the trier of fact or that of a reasonable person in the industry or even that of someone in the same position as the employer.

Second, it is not clear what standard is to be used in determining whether the resultant conduct by the employee would be “inconsistent with the best interests of the customer.” If the resultant conduct constitutes a securities transaction that is not suitable for the customer, the NASD already has a suitability rule to govern the situation. If the resultant conduct is that the employer opens an account with a particular broker-dealer, the proposed IM is overreaching. Whose judgment will

¹ See, e.g., *In the Matter of Albert Fosha*, SEA Release No. 34-22815 (January 21, 1986).

² In this regard, the proposed IM would appear to be in conflict with Rule 3060 which is not being amended.

determine whether an employer should open an account with one broker-dealer instead of another?³

Third, the application of the interpretation to “business entertainment” is similarly not clear. In the NTM, NASD states that business entertainment provided to “employees, agents or representatives” of a customer are covered by Rule 3060. Presumably, although contrary to advice previously given by NASD staff, this would mean that the \$100 limitation of Rule 3060 would apply to such entertainment. Nevertheless, the NTM and proposed IM do not require the \$100 to be applied to such entertainment. Either business entertainment is covered by Rule 3060 or it is not.

Finally, with respect to both gifts and business entertainment, we are deeply troubled by footnote 5 to the NTM. In that footnote, the staff essentially states that any gift or entertainment provided to a natural person who also happens to be an employee, agent or representative of a “customer” would be covered by the prohibitions of Rule 3060 and the proposed IM. As previously stated, Rule 3060 requires that the provision of a gift be “in relation to the business of the employer” before it becomes subject to the rule. Footnote 5, by its language, substantially expands the prohibitions of the Rule in any situation in which a person has any relationship to an entity that is a “customer” whether or not there exists a separate personal relationship by that person with the representative or whether the representative even knows of the existence of a separate customer account. Taken to its extreme, the footnote would prohibit personal gifts for a wedding or other personal events and could even apply to gifts to family members who happen to be employees of “customers.” It is highly questionable how such prohibitions could be fairly said to be in the public interest and appropriate rulemaking.

The Proposed Policies and Procedures Requirements Are Unworkable and Inappropriate

In the proposed IM, NASD would impose substantial new requirements on broker-dealers to have policies and procedures relating to business entertainment. Under the IM, broker-dealers would be required to maintain detailed records of business entertainment and to make such records available to customers. These requirements are virtually unworkable as presently written.

First, because the terms “business entertainment” and “employee” are defined so broadly in the IM, member firms would be put in the impossible position of maintaining records of all entertainment of any kind provided to any client because it could not be certain whether the individual who is being entertained might fall inadvertently now or in the distant future within the proposed rules. The representative providing the

³ The IM initially states that a member should not “act in a manner contrary to the best interests of a customer in the conduct of business with or for such customer” This would appear to suggest that the IM deals with conduct relating to the securities business. The IM goes on to state, however, that a broker-dealer could violate 2110 if it provided entertainment that would be illegal for the customer under virtually any rule of any governmental authority. This is overreaching in that a broker-dealer cannot reasonably be held to know all rules applicable to all businesses outside of the securities industry.

entertainment, and even the individual client accepting the entertainment, may not know that the client's employer maintains an account with the broker-dealer.

Second, there is apparently no limitation on the value of the "business entertainment" that would require recordkeeping. For instance, as currently written, "business entertainment" could include such things as buying an individual breakfast at a business conference that is not even sponsored by the broker-dealer if that individual happens to be an employee of a "customer." No one could reasonably construe such activity as being of interest to any employer. Nevertheless, as currently drafted, the IM would require a broker-dealer to have a record of the purchase. Such recordkeeping, if even possible, would be extremely burdensome with no apparent public benefit.

Lastly, as a practical matter, the records would have to be maintained in the home office of the broker-dealer which would be substantially burdensome for broker-dealers with OSJ supervisory structures. Upon request of any entity maintaining an account with the broker-dealer, the broker-dealer would have to obtain a list of all employees of the entity and conduct a search of all of the records to determine if any entertainment was provided. Until appropriate technology could be built, such a search would have to be manual and would in any event be costly and burdensome.

Conclusion

For the foregoing reasons, we respectfully request that the NASD put substantially more thought into any amendment to Rule 3060 and bring far greater clarity to the rule's purpose. Rules such as the one proposed that are so overbroad and lack reasonable clarity put broker-dealers in the position of establishing policies and procedures which are impossible to implement. Further, the costs of even attempting to comply with such a rule would be enormous. We expect that the overbroad nature of the rule proposal and its potential consequences are likely unintentional. However, we also expect that enforcement of the proposed IM would likely be literal.

We appreciate the opportunity to present our views on this proposal. Should you have any questions, please contact me at 310-257-7442.

Very Truly Yours,

/s/

Jack R. Handy, Jr.
President and CEO