

Broker-Dealer Update

Notice to Members 06 – 69 Regarding Gifts and Gratuities

On December 4, 2006, the National Association of Securities Dealers (“NASD”) issued Notice to Members 06-69 (the “Notice”). It is intended, along with Proposed Interpretive Material-3060 (the “proposed IM”) regarding business entertainment, to provide further guidance to member firms in ensuring their systems and procedures enable compliance with Rule 3060 (Influencing or Rewarding Employees of Others) (the “Rule”) governing gifts and gratuities.

Rule 3060 prohibits any member or person associated with a member from giving, or permitting to be given, anything of value in excess of \$100 per individual per year where such payment is in relation to the business of the recipient’s employer, and requires firms to retain a separate record of all payments and gratuities.

Following a review of the policies, procedures and practices of more than 40 member firms over a two-year period (detailed in the simultaneously issued NASD Report on Examination Findings Regarding Gifts and Gratuities (the “Report”)), NASD has determined that several deficiencies exist in firms’ compliance procedures relating to the application of Rule 3060. The Notice focuses on common compliance weaknesses observed and detailed in the Report, and clarifies several issues with respect to the types of gifts that fall within the scope of the Rule, and what methods must be used to value and account for those gifts.

Personal Gifts/Exclusions

The prohibitions in Rule 3060 generally do not apply to personal gifts, such as congratulatory gifts for a wedding or the birth of a child, provided these gifts are not “in relation to the business of the employer of the recipient.” This determination is based on a number of factors, including the nature of any pre-existing personal or family relationship between the person giving the gift and the recipient, and whether the registered representative paid for the gift. If the firm pays for the gift, NASD presumes the gift is in relation to the business of the employer of the recipient. The Notice clarifies that this analysis applies to all gifts, including those given during the holiday season, or those for events considered personal in nature.

De Minimis and Promotional Items

Rule 3060 does not apply to gifts of de minimis value (e.g. pens, notepads or modest desk ornaments). NASD also generally does not apply the prohibition in Rule 3060 to customary Lucite tombstones, plaques or other “deal toys” commemorating a business transaction, even when such items have a cost of more than \$100, as they are not believed to be items of value within the scope of Rule 3060. However, commemorative items that are not solely decorative, but have other uses (e.g. bicycles commemorating the closing of a transaction), are within the scope of Rule 3060.

The White & Case Broker-Dealer Update provides a brief overview of some of the latest legislative, regulatory and judicial actions, policy statements and decisions that affect broker-dealers.

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Similarly, the Rule does not apply to promotional items of nominal value that display the firm's logo (e.g. umbrellas, tote bags or shirts). However, in order for a promotional item to fall within this exclusion, its value must be substantially below the \$100 limit. Gifts valued in amounts above or near \$100, (e.g. expensive luggage or crystal pieces), even those displaying the firm's logo, are not eligible for the exclusion for promotional items of nominal value.

Aggregation of Gifts

In order to ensure compliance with the \$100 limit per individual recipient per year, firms must aggregate all gifts given by the member and each associated person of the member to a particular recipient over the course of a year. Each firm must also state in its procedures the basis upon which it is aggregating such gifts (e.g. on a calendar year, fiscal year, or on a rolling basis).

Valuation of Gifts

Gifts should be valued at the higher of cost or market value, exclusive of tax and delivery charges. If gifts are given to multiple recipients, members should record the names of each recipient and calculate and record the value of the gift on a pro rata per recipient basis in order to ensure compliance with the \$100 limit.

Gifts Incidental to Business Entertainment

Unless they are promotional or de minimis as described above, gifts given during the course of business entertainment and conferences are within the scope of Rule 3060. Therefore, firms must record these gifts, including their value, as part of their Rule 3060 compliance procedures.

Supervision and Recordkeeping

Compliance with Rule 3060 requires separate recordkeeping of gifts and gratuities. In addition, compliance requires firms to have systems and procedures reasonably designed to ensure that gifts in relation to the business of the employer of the recipient given by the firm and its associated persons to employees of clients of the firm are (i) reported to the firm, (ii) reviewed for compliance with Rule 3060, including the analysis of personal gifts and the consideration of aggregated values as described above, and (iii) maintained in the firm's records.

Firms should check their gift and entertainment policies to ensure that they are in compliance with the Notice. Please contact Gregory P. Gnall or Claudette Robertson Druehl if you have questions concerning the application of this interpretation to your firm.

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