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SECURITIES & CORPORATE COUNSEL

Legal Risk Management Tip
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Gifts, Gratuities, Entertainment and Other Forms of Influence and Reward

With investors still harboring reservations about re-entering the market, many financial firms and their representatives may feel inclined to entice or reward clients and colleagues with gifts or other items for their business. Accordingly, firms and representatives must be aware of the rules and regulations concerning gifts, gratuities, business entertainment and other forms of influence and reward.

Under FINRA Rule 3220, firms and associated persons making gifts and giving gratuities are subject to a $100 per year and per person limit for those items given in relation to business of the recipient's employer. Whether or not a gift made is business related depends on several factors, including whether or not a pre-existing relationship existed between the associated person and the recipient and whether the associated person paid for the gift out of their own personal bank account without reimbursement from the firm. Additionally, this $100 limitation does not apply to lifecycle events or to nominal or promotional items, provided that the nominal or promotional still falls within the $100 limitation.
With respect to giving entertainment gifts such as concert or sporting event tickets, these items will be considered a gift within the purview of the rule if the giver (i.e., the firm or an associated person) does not also attend the event. Certain recordkeeping and supervisory requirements also apply so firms and associated persons should be sure to verify the requirements under FINRA Rule 3220 as well as the terms of the written supervisory procedures to ensure compliance.

Similarly, while an identical $100 gift minimum requirement is not explicit within the Investment Advisers Act of 1940, pursuant to Rule 204A-1, investment advisers are required to set forth a standard of business conduct that the adviser requires of all of its supervised persons, which may include gift and gratuity giving activities. As stated in the final rule release, "[an adviser's] code of ethics should set out ideals for ethical conduct premised on fundamental principals of openness, integrity, honesty and trust."[i] Furthermore, in her March 2008 speech entitled "Focus Areas in SEC Examinations of Investment Advisers: the Top 10," Lori A. Richards, SEC Director of Office of Compliance Inspections and Examinations, identified "the adviser's compliance program and whether it appears designed to capture and manage that particular adviser's compliance risks" such as conflicts of interest as a major focus area in SEC examinations.[ii] Ms. Richards specifically identified "revenue-sharing payment streams from advisers to broker-dealers for obtaining space on the broker-dealers' 'recommended adviser' lists, and other undisclosed compensation and gifts for business (e.g., to solicitors, fund consultants, and municipal consultants)" as common industry arrangements creating a conflict of interest and risk area for the advisers.[iii]

Therefore, when contemplating giving a promotional item, gift of appreciation, conference amenity or even an event ticket, keep in mind the following tips to ensure that your gift, gratuity or reward is still compliant with the rules.

<u>Have you:</u>

☐ Yes ☐ No Verified whether the firm will be reimbursing you for any client or prospective client purchases made?

☐ Yes ☐ No If a group gift, divided the cost of the gift by the number of people in the group to ensure that the cost falls within the $100 limit for the year?

☐ Yes ☐ No If an entertainment gift (such as an event ticket) verified that an associated firm member accompanied the recipient to the event and that his/her attendance is recorded?

☐ Yes ☐ No If part of an adviser referral arrangement, checked that appropriate recordkeeping and supervisory procedures are contained within the firm's policies and procedures manual and are adhered to?

☐ Yes ☐ No Maintained adequate records of the expense reports relating to gifts, gratuities, travel and entertainment in an easily accessible format?

It is essential that firms understand the rules and industry best practices pertaining to gifts, gratuities, travel and entertainment in order to avoid regulatory scrutiny for non-compliance in this area. With particular focus on corporate bonuses and "perks" received by the investing public and regulatory communities, firms are encouraged to test their supervisory systems to ensure it is well equipped to prevent, detect and correct potential or actual violations of its customized gift policies. Check your internal controls and verify that the firm's safeguards are capturing relevant data. Educate associated personnel on the firm's policies and be sure to investigate "red flags" as they are detected in order to manage and mitigate risks.

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[i] Investment Adviser Codes of Ethics: Release Nos. IA-2256, IC-26492; File No. S7-04-04.
[ii] Speech by SEC Staff: Focus Areas in SEC Examinations of Investment Advisers: the Top 10
By Lori A. Richards Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, IA Compliance Best Practices Summit 2008, IA Week and the Investment Adviser Association
Washington, D.C. March 20, 2008 available at http://www.sec.gov/news/speech/2008/spch032008lar.htm.
[iii] Id.