SIFMA
Securities Industry and
Financial Markets Association

June 11, 2007

Via Email
Ms. Nancy Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303

Re: Files Nos. SR-NASD 2006-044 and SR-NYSE-2006-06; Proposed Amendments to NASD Rule 3060 and NYSE 350A Relating to Business Entertainment

Dear Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to offer comment in response to the above-referenced rule filings (the "Proposals") by the New York Stock Exchange ("NYSE") and National Association of Securities Dealers, Inc. ("NASD") (collectively, the "SROs"), which would adopt new rules and interpretive guidance governing business entertainment practices by member firms and their associated persons.

I. Executive Summary

Business entertainment of potential and existing clients is a natural and legitimate component of client development across industries. However, excessive or inappropriate business entertainment practices that are intended to induce a client representative to act contrary to the best interests of that client cannot be countenanced. SIFMA therefore commends the SROs for their efforts to addresses business entertainment practices that give rise to potential conflicts of interest without unduly burdening firms through prescriptive "one-size-fits-all" standards. In particular, we endorse the Proposals' flexible approach to rulemaking which allows each firm to develop, within a prescribed regulatory framework, appropriate, firm-specific policies and procedures tailored to their individual business models.

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

Overall, SIFMA believes the current Proposals achieve the stated regulatory objective of curtailing potentially inappropriate business entertainment practices that could give rise to conflicts of interest by client fiduciaries. SIFMA therefore generally supports the Proposals and offers several comments and recommendations aimed at more precisely focusing the scope of the Proposals on those areas in which potential conflicts of interest are most likely to arise. SIFMA recommends, among other things, that the SROs: (i) limit the Proposals to business entertainment provided by associated persons engaged in sales, trading, research or investment banking activities on behalf of customers of the U.S. broker dealer; and (ii) modify the applicability of the Proposals with respect to business entertainment of individual clients acting in a personal capacity where the individual client's employer is also a client of the firm.

Moreover, due in large measure to the complexity of systems integration and data issues involved in capturing and aggregating entertainment expenses across business units, SIFMA urges the SROs to provide firms with a minimum of nine months to develop, implement and test their record-keeping and tracking systems. It is widely believed within the industry that, even if the SROs modify the Proposals as requested herein, a six-month time frame is wholly inadequate to address the multitude of issues associated with defining the universe of covered employees, creating unique client identifiers and integrating disparate systems.

Additionally, SIFMA provides several comments intended to better serve the principles-based approach to regulation sought by the Proposals while still preserving their over-arching objectives. SIFMA commends the SROs for their considerable efforts in developing these important Proposals and thanks them for their continued willingness to consider our comments and concerns. SIFMA's detailed comments follow below.

II. The Proposals Are Overly Broad in Scope

A. Associated Persons

SIFMA believes the Proposals' application to all "associated persons" is overly broad in scope because it indiscriminately applies to business entertainment provided by a wide range of member firm employees both within the U.S. broker-dealer and across affiliated entities regardless of the potential for conflicts sought to be addressed by the Proposals. As a result, members firms' recordkeeping burdens under the Proposals are increased considerably with little corollary regulatory benefit. SIFMA respectfully suggests that a more measured and equally effective approach is one that limits the reach of the new rules to client-facing employees in a position to potentially influence the behavior of a client representative in contravention of the client's best interests.

As proposed, the new rules would generally reach all business entertainment of a member firm and its associated persons, "even if such entertainment occurs outside of the Unites States or is provided to foreign individuals." With respect to persons employed by an affiliated non-member firm (both domestic and foreign), the Proposals state that application of the new rules will hinge on whether the employee is an "associated person"

of the U.S. member firm and provide several factors to be considered in determining associated person status of non-member firm employees.[2]

SIFMA sincerely appreciates the SROs' efforts to provide clarity in this area. We note, however, our ongoing concern about the collateral consequences of a broad application of the associated person definition to individuals employed by affiliated non-member firms, and more particularly the extension of SRO rules beyond traditional jurisdictional limits to affiliated entities that are already subject to oversight and supervision of other U.S. or non-U.S regulators.[3]

With regard to these Proposals, it is unclear, for example, to what extent the new rules would apply to persons employed outside the U.S. broker-dealer simply by virtue of their holding U.S. licenses. Read broadly, the Proposals could suggest that member firms' recordkeeping obligations extend to business entertainment by *all persons employed by and/or registered with the U.S. member firm,* regardless of the person's functional responsibilities or employment location within the global organization.

From an economic and resource perspective, such a construction would be untenable for member firms and would contribute little to the underlying core customer protection objectives sought by the Proposals. Especially for large global financial services firms that have distinct travel and entertainment systems for each corporate entity, creating and maintaining interconnectivity of systems across affiliated entities for purposes of tracking entertainment expenses on a global basis would be extremely burdensome and costly. Moreover, it would export SRO rules overseas, which would create an uneven playing field for foreign affiliates of the U.S. broker-dealer.[4]

SIFMA believes that a more practical yet equally effective alternative would be to focus the breadth of the Proposals on business entertainment provided by client-facing employees in a position to influence or direct the behavior of persons acting in a fiduciary capacity with respect to the member firm's client. To that end, SIFMA recommends that the SROs limit the Proposals' coverage to business entertainment provided by persons engaged in sales, trading, research or investment banking activities with, or on behalf of, customers of the U.S. member firm. Moreover, because aggregation across legal entities would be an enormously difficult and costly undertaking, SIFMA also recommends that the SROs allow firms to aggregate business expenses on a legal entity basis. This approach, applied against the backdrop of existing firm internal controls and supervisory

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[2] The Proposals state that not all persons who are employed in commonly controlled affiliates of a financial services company operating in the United States and/or foreign jurisdiction are necessarily associated persons of the member even if they report to a person, who in another capacity, is an associated person.

[3] Many large financial service companies are subject to regulatory oversight by the FSA, Federal Reserve Bank, and OCC, among others.

[4] For example, a manager of global business with a series 7 could potentially be subject to both U.S. SRO rules and local rules when entertaining a Japanese client in Japan. If that same manager worked for an international company that did not have a U.S. affiliate, the business entertainment rules would not apply. We believe that such disparate treatment implicates U.S. competitive issues and should be carefully considered before U.S. rules and regulations are applied across the board to overseas activities aimed at foreign customers that are otherwise protected by their local laws and regulatory authority.

practices would enable firms to build cost-effective, risk-based business tracking and surveillance systems that concentrate on functional areas that would most likely implicate the regulatory concerns described in the Proposals.

Thus, under SIFMA's alternative, the Proposals would carve-out business entertainment by employees not engaged in sales, trading, research or investment banking function on behalf of U.S. customers. This would include U.S. licensed persons employed in commonly controlled domestic and/or foreign affiliates of the U.S. member firm not engaged in the forgoing activities. In addition, other non-client facing persons employed within functional control and administrative areas (e.g. Compliance, Legal, Risk, Audit, Finance and Human Resources) as well as back-office support (e.g. Technology and Operations) -- all of whom are covered in the "permissive" registration category of NASD Rule 1031(a)(3) [5] -- would also fall outside the Proposals. In our view, because business entertainment by these types of employees is a "low-risk" activity, the burdens to member firms in building systems to track entertainment expenses in this context greatly outweigh the regulatory benefits. Accordingly, SIFMA urges the SROs to modify the Proposals as described herein.

B. Individual Customers That Are Client Representatives

SIFMA also requests the SROs reconsider the Proposals' approach to business entertainment of individual clients that also act as "customer representatives" with regard to other corporate clients of the member firm. SIFMA believes the Proposals' treatment of business entertainment of these types of individuals is overreaching and, unless modified, unreasonably expands the breadth of the Proposals.

Under the current Proposals, business entertainment provided to "natural persons" would generally fall outside the scope of the new rules. SIFMA applauds and agrees with the Proposals' recognition that entertainment of individual customers in their personal capacity ("individual customer entertainment") does not raise the potential conflicts the Proposals are designed to address. SIFMA also agrees that employees cannot intentionally circumvent their firms' business entertainment policies by asserting that the entertainment was provided to the natural person in his or her "individual" capacity and not as a client representative.

We disagree, however, with the SROs' conclusion that in instances where the recipient of the business entertainment is also a representative of another firm client, then the individual customer entertainment would fall under the Proposals unless information barriers exist within the firm. The language at issue states:

> *If a person is entertained in his personal capacity as a natural person client, and the firm has information barriers that would prevent the person providing the*

[5] NASD Rule 1031(a)(3) states in relevant part that a member may "maintain or make application for the registration as a representative of a person who performs legal, compliance, internal audit, back-office operations, or similar responsibilities for the member, or a person who performs administrative support functions for registered personnel, or a person engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member."

> *business entertainment from knowing that the person represents another customer as a representative, and the person providing business entertainment has no knowledge that such person is a representative of a customer at the time of the business entertainment, then such entertainment would fall outside the scope of the IM.*[6]

Basing the exception on whether the entertainer knows that the client is a representative of a customer significantly undermines the utility of the "natural person" exception. Information barriers in this context are meaningless because the entertainer of an individual client will undoubtedly know (and for suitability purposes, should know) the individual's employment information. Moreover, because the term "customer representatives" includes employee of corporate customers, the Proposals would extend to a wide range business entertainment provided to individual retail customers that the Proposals specifically intended to exclude. In most cases, these employees do not have the authority to influence or direct the employer's business decisions because of lack of seniority or proximity within the organization, or because of the type of business the employer conducts with the member firm.

Instead of relying on information barriers, and in order to preserve the natural person exemption, SIFMA recommends the SROs include language in the rules specifically stating that firms and their associated persons cannot do indirectly what they are prohibited from doing directly. SIFMA also recommends the SROs make clear that the Proposals are intended to apply to those situations where: the recipient of the business entertainment is in a position to direct or influence the securities investment activities of the corporate client, *and* the provider of the entertainment has a business relationship with the corporate client. Firms would then be required to adopt policies and procedures reasonably designed to prevent abusive business entertainment practices with regard to these types of client. Such polices and procedures could, for example, consider several factors including: (i) potential for undue influence and conflict of interest; (ii) firm policies and procedures regarding entertainment of other similarly-situated individual clients; and (iii) whether the representative providing the business entertainment stands to derive financial benefit, directly or indirectly, from the corporate account.

Thus, under SIFMA's recommended approach, entertainment expenses incurred by a registered representative ("RR") that services the personal or private banking account of a Chief Executive Officer ("CEO") generally would fall outside the rules, even though the CEO's company has a business relationship with the RR's firm – unless, of course, the RR also had a business relationship with the corporate account. In other words, absent a nexus between the RR and the corporate client relationship (e.g. the RR is part of team/unit that services the corporate account; or the RR is in a position that can influence or direct securities and investment activities of the corporate account), the mere fact that the individual client also is an customer representative is irrelevant and would not warrant aggregation of individual customer entertainment expenses across business units. Indeed, for firms that maintain separate retail and institutional technology

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[6] NASD Filing at 28750. Notably, the NYSE filing does not contain a similar qualification.

platforms, aggregation under such circumstances would be extremely burdensome. SIFMA therefore requests the SROs modify this aspect of the Proposals as well.

III. Implementation/Technology Issues

SIFMA also urges the SROs to reconsider the six month implementation period for compliance with the recordkeeping requirements of the Proposals. Today, many member firms have policies and procedures in place governing business gifts and entertainment, and therefore are well positioned, upon reasonable notice, to update their written procedures to include appropriate, firm-specific entertainment standards across their organization. Firms generally also have procedures and systems designed to document, review and approve client-related gift, travel and entertainment expenses within *individual* business units.

Firm systems, however, typically do not track these types of expenses at the level contemplated by the Proposals (i.e. aggregated by individual customer representative across different business lines). Nor are simple vendor solutions available today for that purpose. Consequently, many firms have been exploring various options in anticipation of the final rules.[7] Based on these efforts, it is widely held by the membership that a six-month implementation period for the record-keeping requirements of the Proposals is simply not enough time, due in large measure to the complexity of systems integration and data issues involved in capturing and aggregate business entertainment expenses.

Though the Proposals' recordkeeping language is seemingly straightforward, the time, effort and resources needed to design, develop and deploy the requisite systems enhancements in order to fully comply with this aspect of the Proposals cannot be overstated. This is especially relevant for larger, full-service firms that employ multiple and sometimes discrete client-databases containing different codes or nomenclatures for the same client. Depending on the business unit, specific system or program that houses the information, client codes could vary within the same firm. Many firms therefore face a complex and expensive process of converting systems to track consolidated expenditure information based on unique, firm-wide identifiers for customers and customer representatives.

Moreover, as with other technology driven regulatory initiative, firms must have sufficient time to analyze, expose and resolve any inevitable systems "glitches" in advance of implementation. There is also testing and training of personnel to be considered. Factor in increased demands on technology staff, and other regulatory and business initiatives with which members must contend, and it is exceedingly clear that six-months is not as long a period as some would believe. To avoid hasty implementation, which only increases the likelihood for mistakes and future corrective action, SIFMA therefore urges the SROs to provide *a minimum* nine month

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[7] For example, some firms are considering integrating data feeds from diverse systems across their firms into their travel and entertainment systems. Other firms are creating new client identifiers (such as email addresses) for these purposes.

implementation period, with the recognition that firms may seek an extension if they can demonstrate to the satisfaction of the SROs that additional time is necessary.

Notably, and notwithstanding member firms' efforts to date in anticipation of the final rules, the fact remains that many key terms as well as the scope of the rules that are critical to systems programming (e.g. what is meant by "customer representative") have yet to be finalized. As such, firms have not commenced – and could not commence in earnest -- full systems programming, testing and training until the Proposals were finalized. Indeed, as we foresee additional interpretive guidance and clarification even after the final rules are approved, it is imperative that firms be afforded sufficient time at the outset in order to manage their resources in the most effective and efficient manner possible.

IV. Other Comments

The Proposals require, among other things, that members adopt detailed policies and procedures that define specific types of appropriate business entertainment. In developing the Proposals, the SROs recognized that a single business entertainment standard for all members "was unworkable and impractical" and, instead, chose a "*principles-based*" approach that permits each member to create policies tailored to its business needs since members are "in the best position to determine appropriate limitations and restrictions on the business entertainments provided by its" employees.

In this regard, SIFMA offers several comments regarding various provisions within the Proposals which we believe deviate from a principles-based approach to regulation. In our view, principles-based regulation involves a regulator moving away, where possible, from dictating in the first instance how a firm should reach a desired regulatory outcome. This does not remove the need for detailed rules, but suggests an approach where the analysis does not as a default begin with the creation of a rule. Instead it considers first whether firms, supplemented by guidance as appropriate, could assume the responsibility to achieve those desired outcomes in the context of their business processes and existing supervisory obligations.

A. Providing Business Entertainment Records to Customers

The Proposals require that members maintain detailed records of the nature and cost of business entertainment, and make such information available to customers upon request.[8] SIFMA certainly agrees that accurate and robust tracking systems are an important means of guiding and enforcing appropriate behavior, and therefore supports providing business entertainment data to clients. We request, however, that the SROs provide firms with the latitude to determine the form, frequency and scope of information to be given to clients upon request. Each firm's procedure could identify a designated recipient of the information, the firm contact person to whom customer requests are made, a window for submission of requests, time periods for which information may be available (e.g. year-to-date information), the frequency with which the information must

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[8] As currently written, the Proposals capture "any business entertainment records regarding business entertainment provided to customer representatives of that customer."

be provided, and the scope of information to be provided. Under this approach, firms can better manage information flow in light of confidentiality obligations, as well as avoid duplicative requests for business entertainment information by different representatives of the same client. [9] It is important to note that this added flexibility for firms would not diminish the SRO's ability to review such information as part of examinations or regulatory requests for information since firms will still maintain such information in the manner prescribed by the Proposals. It will however, allow firms to plan and allocate resources in a more efficient and cost effective manner to respond to client requests for information.

B. Post Event Review

SIFMA also requests that NASD reconsider its position on a post-event review mechanism for entertainment expenses that exceed a specified threshold. In this regard, NASD states that there is “no effective means of rescinding business entertainment that has already been provided,” and suggested instead that employees concerned about the potential costs should obtain prior approval of higher spending limits in advance of the event.

While business entertainment cannot be rescinded, SIFMA believes the Proposals should permit firms to implement a post-event supervisory review mechanism to address instances where a business entertainment event unexpectedly, and in good faith, exceeds a threshold. For example, a member firm employee may exceed a threshold during dinner at an otherwise “appropriately” priced restaurant as a result of a customer ordering an expensive entrée or bottle of wine (which the employee cannot politely prevent). Under such circumstances, we believe it is entirely reasonable that the employee’s supervisor review, and if appropriate approve or disapprove, the business entertainment expenses without the approval or disapproval being deemed a violation of the Proposals. Accordingly, and in keeping with principles-based approach, SIFMA requests the SROs permit post-event approval, provided of course that firms also have policies and procedures designed to prevent abuse of the post-event approval process.

C. Definition of “Family Members”

SIFMA also requests that the SROs expand the term “family members” to include grandparents and other further removed relatives similar to NASD Rule 2370. [10] As proposed, the definition of “customer representative” excludes certain direct “family members” of the customer, such as parents, spouses, siblings and children. The SROs

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[9] E.g., disclosure of entertainment by a firm’s Investment Banking and Research Divisions may inadvertently alert clients and others within the firm of internal investment banking activities, potentially violating the Global Settlement. SIFMA respectfully requests that the Commission address these issues in its adopting release.

[10] NASD Rule 2370 defines immediate family members as "parents, grandparents, mother-in-law or father-in-law, husband or wife, brother or sister, brother-in-law or sister-in-law, son-in law or daughter-in-law, children, grandchildren, cousin, aunt or uncle, or niece or nephew, and shall also include any other person whom the registered person supports, directly or indirectly, to a material extent."

provide this carve-out in order to address situations where family members have authority over another family account, such as Uniform Gifts to Minors Act accounts. These types of arrangements, the SROs noted, are unlikely to result in the types of conflicts of interest the Proposals seek to address, and therefore would constitute an undue regulatory burden on member firms.

Because this rationale applies equally to other relatives beyond those delineated in the Proposals and because most firm systems typically do not distinguish types of relatives, we ask that the SROs reconsider the definition of "family members" as described above so that firms can customize their policies and procedures as best suited to their business models. Moreover, we request the SROs to confirm that individual/personal trust accounts would not be covered by the new rules.

D. Firm Liability

SIFMA also seeks confirmation regarding the relative responsibilities of the firm and the customer who is being entertained. While it is reasonable that member firms implement policies and procedures to address potential conflicts of interest that may arise in connection with business entertainment, member firms cannot -- nor are they in a position to -- ensure that the customer representative's conduct is consistent with the best interests of, or fulfills the full range of duties owed to, the client.[11] That responsibility lies solely with the customer.

To avoid any suggestion that the business entertainment imposes a supervisory responsibility on the member firm of its customers' conduct, SIFMA therefore requests the SROs acknowledge these different responsibilities and affirm that broker-dealers would not assume any additional obligations to customers, such as evaluating and/or monitoring the activities of a customer's employees or representatives. In that regard, we ask the SROs to strike or modify[12] the language in paragraph (c)(1)(D) of the Proposals which references business entertainment that "could otherwise undermine the performance of a customer representative's duty. . . ."

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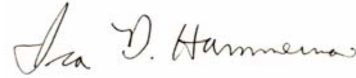
Once again, SIFMA appreciates the opportunity to provide comments in response to the SROs rule filings governing member firm business entertainment practices. SIFMA commends the SROs for considerable efforts with regard to these important proposals and thanks them for their continued willingness to work with the industry in

[11] The customer's responsibilities to account holders, investors, and shareholders are themselves governed by extensive and longstanding laws and regulations, contractual language, company policies, industry codes of conduct -- all of which play a critical part in the decisions of how and with whom business is to be conducted.

[12] E.g., the language in the general introduction ("intended to designed to cause…") could replace the language in paragraph (c)(1)(D) ("or that could otherwise undermine the performance of a customer representative's duty…").

developing flexible rules and guidance that seek to address potential conflicts of interest without interfering with legitimate business practices and client development. If you have any questions or require further information, please contact Amal Aly, SIFMA Managing Director and Associate General Counsel at (212) 618-0568.

Sincerely,



Ira D. Hammerman
Senior Managing Director and
General Counsel

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Annette L. Nazareth, Commissioner
The Honorable Kathleen L. Casey, Commissioner

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