CORE COMPLIANCE & LEGAL SERVICES, INC.

Risk Management Update
November 2014

YEAR-END PLANNING FOR GIFTS AND ENTERTAINMENT

With the year-end upon us, more firms are considering gifts for giving to clients, vendors, employees, and referral sources to celebrate drawing another successful year to a close. Naturally, this begs the question as to what the regulatory requirements are, including monetary thresholds for giving and receiving gifts. While the Securities and Exchange Commission ("SEC") has offered little in the way of formal guidance to investment advisers ("IAs"), FINRA has provided specifications in Rule 3220[1] for broker-dealers. This allows the financial industry to evaluate various considerations when formulating their gift policy. This month's Risk Management Update will address: (1) what is considered a gift; (2) what value is acceptable; and (3) what compliance considerations must be given when giving or receiving gifts.

What is Considered a Gift

The definition of "gifts" is broadly defined in the financial industry and generally includes merchandise, favors, benefits, or other things of value that could influence a client or prospective client's decision-making process. Examples of common gifts that firms typically give to clients include gift cards to restaurants or stores, merchandise such as pens, branded products, gift baskets, flowers, candy, entertainment tickets for sporting events, theater shows, concert tickets and films. Notably, cash is not an allowable gift to give or receive.

What Value is Acceptable

Under FINRA Rule 3220, the limit is **one hundred dollars** ($100) per individual per year and such limit applies to "any person, principal, proprietor, employee, agent or representative of another person where such payment is in relation to the business of the employer or the recipient of the payment…"[2] For broker-dealers, FINRA's rule is explicitly clear. It also details the books and records requirements for members to keep a separate record of all gifts and maintain such records for no less than six years (the first two of which the records be in an easily accessible place).[3]

On the other hand, for IAs the SEC has provided very little specific guidance on this subject. One reference they made was in Footnote 17 of the Investment Adviser Act Code of Ethics Rule which outlines some other provisions IAs should consider for their Code of Ethics, including, "*limitations on acceptance of gifts.*"[4] The SEC provides no dollar amount or information in regards to IAs maintaining records regarding gifts given or received.

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[1] http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=5665
[2] http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=5665
[3] http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/interpretationsfor/p037775.pdf
[4] http://www.sec.gov/rules/final/ia-2256.htm

Consider the following scenarios:

Scenario 1: John works for ABC Advisory Company as an investment adviser representative. ABC Company abides by a written Code of Ethics that includes a provision on gifts and entertainment which includes a maximum of $100.00 per year per client for gifts given. John gives his client Mary a $50.00 gift certificate to a major department store in March in honor of Mary's wedding. Then, in November, John sends Mary a Cornucopia gift basket filled with fruit that is valued at $47.99. In early December, John buys tickets to the Opera to celebrate his 15th wedding anniversary with his lovely wife Lily, which are valued at $150.00. The day before the show, Lily gets sick and does not feel she can make it. John sees Mary for a client meeting and since he and Lily have decided not to go, thinks about offering the tickets to Mary as he does not want the tickets to go to waste.

Question: *Can John offer the tickets to Mary?*

Answer: No. John should not offer the tickets to Mary. The Firm's Code of Ethics contains a provision in regards to gifts and entertainment wherein the Firm has set the maximum aggregate value per year, per client at $100.00. The value of gifts that John has given to Mary this year so far totals $97.99. Even though John did not buy the Opera tickets with the intention of giving them to Mary (*i.e.*, counting towards the total aggregate value), John still must take into consideration the fair market value of the Opera tickets which is $150.00. Therefore giving those tickets to Mary would bring the aggregate value of gifts given to her within the year to $247.99, which would exceed the Firm's gifts and entertainment provision.

Scenario 2: Sam, who is a supervised person of XYZ Advisory Company wants to give flowers valued at $50.00 to client Virginia due to a death in her family. However, earlier that year, Sam had given basketball tickets to client Virginia that had a value of $160.00. The Code limit for giving gifts is $200.00.

Question: *Is it permissible for Sam to give client Virginia the flowers*?

Answer: There may be times when exceptions can be made for extenuating circumstances, such as a death in a client's family. When exceptions arise, the supervised person should obtain written approval from the CCO or other senior manager prior to giving the gift that would exceed the Code limit. Additionally, the reason for the exception should be documented.

Compliance Considerations When Giving or Receiving Gifts

Compliance personnel should be mindful of the potential conflicts of interest that surround the giving and receiving of gifts. Below are some things to consider:

(1) Whether the gift could be viewed as <u>excessive</u> or a <u>bribe</u>.
(2) Pre-clearance protocols at the firm and whether additional controls are necessary.
(3) Specific thresholds set forth by the firm that could be more stringent than regulatory guidance.
(4) Whether other supervised persons may have given gifts to the same client or vendor.
(5) Maintenance of books and records for approvals and exceptions.

Best practice would be to require supervised persons to seek pre-approval of all gifts and entertainment given to clients by submitting a form to the CCO in advance of giving the gift. This provides the Firm with books and records in regards to gift giving and allows the CCO a way to track all gifts being given in order to monitor which supervised persons are giving gifts to which clients and to ensure compliance with firm procedures and applicable regulations.

Conclusion

The easiest way to avoid conflicts surrounding gifts is to have a policy that prohibits the giving and receiving of gifts to/from anyone doing business with the firm. However, that approach is not always practical and for most firms can be a difficult task. Mitigation of such conflicts can be obtained with the implementation of adequate policies, procedures, and internal controls, such as pre-approval, reporting, certifications, and/or testing, which in turn gives a gift to the CCO of having less to worry about during the holiday season.

Author: Brooke Freitas, Compliance Analyst; Editor: Michelle L. Jacko, CEO, Core Compliance & Legal Services, Inc. ("CCLS"). CCLS works extensively with investment advisers, broker-dealers, investment companies, hedge funds, private equity firms and banks on regulatory compliance issues. For more information about this topic and other compliance consultation services, please contact us at (619) 278-0020, info@corecls.com or visit www.corecls.com.