

MEMO# 31636

March 4, 2019

FINRA Staff Permits Pre-Inception Index Performance in Institutional Communications for Open-End Funds

[31636]

March 4, 2019 TO: ICI Members SUBJECTS: Advertising
Compliance
Disclosure
Distribution
Fund Accounting & Financial Reporting
Investment Advisers RE: FINRA Staff Permits Pre-Inception Index Performance in
Institutional Communications for Open-End Funds

In late January, FINRA staff issued an interpretive letter permitting the inclusion of pre-inception index performance (“PIP”) data in institutional communications concerning passively-managed open-end funds, subject to numerous conditions.[\[1\]](#)

Background

FINRA Rule 2210 governs broker-dealers’ communications with the public. Its content standards require that communications be fair and balanced; provide a sound basis for evaluating the facts in regard to any particular security; not omit material information; and not include false, exaggerated, or misleading statements, or misstate material facts.[\[2\]](#) In 2013, FINRA staff issued interpretive guidance to ALPS Distributors, Inc., permitting the use of PIP data in institutional communications for certain passively-managed exchange-traded products (“ETPs”), subject to numerous conditions regarding the presentation and use of such data.[\[3\]](#)

Summary of Letter

Foreside Funds Services, LLC (“Foreside”) requested interpretive guidance regarding the use of PIP data in communications concerning passively-managed open-end investment companies (including separately-managed series of a business trust) (“funds”) that are distributed solely to institutional investors (as defined in FINRA Rule 2210(a)(4)). (By its terms, the ALPS Letter’s relief extended only to ETPs.)

In the Interpretive Letter, FINRA staff stated that the use of PIP data in institutional communications concerning funds in the manner proposed by Foreside is consistent with Rule 2210. Below is a summary of the conditions, which are similar to those in the ALPS

Letter:

- Any marketing material that includes PIP data will be clearly labeled (“For use with institutions only, not for use with retail investors”), and financial intermediaries will be instructed not to circulate those communications to retail investors.
- Any PIP data will be used only with respect to an index created according to a pre-defined set of rules that cannot be altered except under extraordinary market, political or macroeconomic conditions.
- PIP data will not be used to market the fund if the fund alters its investment strategy to permit active management of its portfolio.
- Any marketing material containing PIP data will include an offer to provide an overview of the index’s methodology upon request, and electronic marketing material will include a hyperlink to such information.
- The presentation of PIP data will reflect the deduction of fees and charges currently applicable to the fund.
- PIP data will reflect a period of time that includes multiple securities market environments, and at a minimum, ten years of pre-inception data.
- PIP data will be current as of the most recently ended calendar quarter.
- PIP data will be clearly labeled and shown separately from fund performance and will be presented along with disclosure of the applicable dates for the PIP data and the dates for actual fund performance since inception.
- If the fund has been in existence for more than one year, the use of PIP data will be accompanied by the prominent presentation of actual fund performance since inception that reflects the deduction of the fund’s fees and charges.
- PIP data will not be inconsistent with information in the prospectus but may be used regardless of whether the fund prospectus contains the data.
- PIP data will be accompanied by several disclosures.[\[4\]](#)

The Interpretive Letter also reiterates FINRA’s view that presentation of hypothetical back-tested performance in communications used with retail investors does not comply with FINRA Rule 2210(d).

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endnotes

[\[1\]](#) Interpretive letter to Meredith F. Henning, Foreside (Jan. 31, 2019)(“Interpretive Letter”), available at www.finra.org/industry/interpretive-letters/january-31-2019-1200am.

[\[2\]](#) FINRA Rule 2210(d)(1)(A) and (B).

[\[3\]](#) Interpretive letter to Bradley J. Swenson, ALPS Distributors, Inc. (Apr. 22, 2013)(“ALPS Letter”), available at www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P246651.

[\[4\]](#) The material must disclose the following: (i) that the fund is a relatively new product and any performance prior to the date of inception is hypothetical; (ii) the identity of the entity that performs the calculation and distribution of the PIP data, and whether any fund

affiliate pays this entity to perform those functions; (iii) that PIP data are based on criteria that have been applied retroactively with the benefit of hindsight, and that these criteria cannot account for all financial risk that may affect actual fund performance; (iv) that actual fund performance may vary significantly from the PIP data; and (v) reasons (if any) why the PIP data would have differed from actual fund performance during the period shown (e.g., transaction costs, liquidity, or other market factors).

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