

**MEMO# 26321**

July 20, 2012

# **New FINRA Rules Governing Communications With the Public**

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TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 16-12  
CLOSED-END INVESTMENT COMPANY MEMBERS No. 45-12  
INTERNAL SALES MANAGERS ROUNDTABLE No. 4-12  
SALES FORCE MARKETING COMMITTEE No. 4-12  
SEC RULES MEMBERS No. 66-12  
SMALL FUNDS MEMBERS No. 27-12 RE: NEW FINRA RULES GOVERNING COMMUNICATIONS WITH THE PUBLIC

The Securities and Exchange Commission has approved proposed changes to FINRA's rules governing communications with the public. [\[1\]](#) The rule changes will become effective on February 4, 2013. [\[2\]](#) The new rules are described below, with an emphasis on how they differ from the current rules.

## **Reorganization of Current Rules**

New FINRA Rules 2210 and 2212 through 2216 will take the place of (with some changes) existing NASD Rules 2210 and 2211, most of the Interpretive Materials that follow NASD Rule 2210, and the provisions of Incorporated NYSE Rule 472 [\[3\]](#) other than those pertaining to research analysts and research reports. The Notice indicates that proposed FINRA Rule 2211 (Communications with the Public About Variable Insurance Products) will be the subject of a separate proposal.

## **Categories of Communications (Rule 2210(a))**

Under the current rules, there are six categories of communications: advertisement; sales literature; correspondence; institutional sales material; independently prepared reprint; and public appearance. Certain requirements (e.g., principal pre-use approval, filing, and content standards) apply differently to each category.

The new rules divide all communications into three categories: retail communication;

correspondence; and institutional communication.

- Retail communication means “any written (including electronic) communication that is distributed or made available to more than 25 retail investors [4] within any 30 calendar-day period.” The Notice indicates that communications that currently qualify as advertisements and sales literature generally fall under this category.
- Correspondence means “any written (including electronic) communication that is distributed or made available to 25 or fewer retail investors within any 30 calendar-day period.” This definition differs from the current definition in several ways, including that it no longer distinguishes between existing and prospective retail customers, and it covers any type of written communication, rather than just certain enumerated types. [5]
- Institutional communication means “any written (including electronic) communication that is distributed or made available only to institutional investors, [6] but does not include a member’s internal communications.” [7]
  - Clarification of “Reason to Believe” Standard
  - As under current rules, the new rules provide that “[n]o member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any retail investor.” [8] The Notice clarifies that the “reason to believe” standard does not impose an affirmative obligation on firms to inquire whether an institutional communication will be forwarded to retail investors every time they distribute such a communication. Nor does it make a fund underwriter responsible for supervising the associated persons of recipient broker-dealers.
  - The Notice states that firms should have, and make appropriate efforts to implement, policies and procedures reasonably designed to prevent institutional communications from being forwarded to retail investors. The procedures may include the use of legends indicating that an institutional communication is for institutional investor use only.

The Notice further indicates that if a firm becomes aware that a recipient institutional investor is forwarding or making available institutional communications to retail investors, the firm must treat future communications to that institutional investor as retail communications until it reasonably concludes that the improper practice has ceased. Similarly, a fund underwriter must follow up on any “red flags” indicating that a recipient broker-dealer has used or intends to use an institutional communication provided by the underwriter with retail investors. If the underwriter determines that this is the case, the underwriter must treat institutional communications distributed to that broker-dealer as retail communications (or cease distribution) until the underwriter reasonably concludes that the broker-dealer has adopted appropriate measures to prevent redistribution.

## **Approval, Review and Recordkeeping Requirements (Rule 2210(b))**

The new rules require that an appropriately qualified registered principal approve each retail communication before the earlier of its use or filing with FINRA, subject to certain exceptions. [9] The exceptions largely track those under current rules and related

interpretations. The new rules expand, however, the current exception for correspondence that is sent to 25 or more existing retail customers within any 30 calendar-day period and that does not make any financial or investment recommendation or otherwise promote a product or service of the firm. Under the new rules, this exception will apply to all retail communications that do not make such recommendations or promote such products or services. The new rules also authorize FINRA to grant individual exemptions from the principal pre-use approval requirements for good cause shown after taking into consideration all relevant factors, provided that the exemption is consistent with the purposes of FINRA Rule 2210, the protection of investors and the public interest.

The Notice indicates that the new rules generally maintain the supervision and review standards for correspondence and institutional communications that apply to correspondence and institutional sales material under current rules. Likewise, the recordkeeping requirements for retail and institutional communications generally mirror current recordkeeping requirements. [\[10\]](#) Regarding correspondence recordkeeping requirements, the new rules cross-reference NASD Rule 3010(d) and FINRA Rule 4511.

## **Filing Requirements (Rule 2210(c))**

The new rules generally incorporate current filing requirements, but with certain changes.

- New member firms. As under current rules, new FINRA member firms will still be required to file materials with FINRA at least 10 business days prior to first use for a one-year period. Changes include that the pre-filing obligation extends to certain enumerated broadly disseminated retail communications, rather than just advertisements. In addition, under the new rules the one-year period will begin on the date the firm's FINRA membership became effective, rather than the date a firm first files an advertisement with FINRA.
- FINRA authority to require pre-filing. The new rules authorize FINRA's Advertising Regulation Department, if it determines that a firm has departed from FINRA standards, to require the firm to pre-file all of its communications (rather than just advertisements and/or sales literature, as under current rules) or a specified subset.
- Pre-use filing requirements. Current rules require firms to pre-file certain communications and withhold them from use until any changes specified by the Advertising Regulation Department have been made. Under the new rules, the categories of communications subject to this requirement will include, among others: (1) retail communications concerning any registered investment company that include self-created rankings; and (2) retail communications that include bond mutual fund volatility ratings.
- Concurrent with use filing requirements. The new rules will revise the categories of communications that must be filed within 10 business days of first use or publication. Notably, in a change from current rules, the requirement will apply to all retail communications concerning registered investment companies. This change will affect closed-end funds, as current rules limit the filing requirement for closed-end funds to advertisements and sales literature distributed during the fund's initial public offering period, as well as all advertisements and sales literature concerning continuously offered closed-end funds (i.e., interval funds). Consistent with current requirements, firms will be required to file within 10 business days of first use any templates for written reports produced by, or retail communications concerning, an investment analysis tool.
- Exclusions from filing requirements. The Notice indicates that the new rules generally

duplicate the current exclusions from the filing requirements, with certain modifications. [\[11\]](#) The new rules exclude from filing:

- Retail communications that previously have been filed with FINRA and that are to be used without material change.
  - Retail communications that are based on templates that were previously filed if the changes are limited to updates of statistical or other non-narrative information. This exclusion is based, in part, on an earlier NASD staff interpretation.
  - Retail communications that do not make any financial or investment recommendation or otherwise promote a product or service of the firm. This exclusion is new.
  - Retail communications that do no more than identify a firm's national securities exchange symbol or a security for which the firm is a registered market maker, or that do no more than identify the firm or offer a specific security at a stated price.
  - Certain "tombstone" advertisements governed by Rule 134 under the Securities Act of 1933 (unless related to securities issues by registered investment companies or publicly offered direct participation programs).
  - Press releases that are made available only to members of the media.
  - Prospectuses and other documents that have been filed with the SEC or any state, other than (1) investment company omitting prospectuses published pursuant to Securities Act Rule 482, and (2) broadly disseminated free writing prospectuses. [\[12\]](#)
  - Reprints of independently prepared articles or reports.
  - Correspondence and institutional communications.
  - Communications that refer to types of investments solely as part of a listing of products or services offered by the firm.
  - Retail communications posted on an online interactive electronic forum. Under current rules, these communications are treated as "public appearances," which are not subject to filing requirements.
  - Press releases issued by closed-end investment companies listed on the New York Stock Exchange that are subject to the "immediate release policy" under NYSE rules. This exclusion is new.
- Exemptive authority. FINRA is authorized to grant exemptions (1) from the pre-use filing requirements for new FINRA members for good cause shown, and (2) from the requirements to file certain retail communications concurrent with use for good cause shown after taking into consideration all relevant factors, provided that the exemption is consistent with the purposes of Rule 2210, the protection of investors and the public interest.

## **Content Standards (Rule 2210(d))**

The new rules reorganize but largely incorporate the current content standards. The new rules expressly prohibit promissory statements or claims (which FINRA already interprets the current rules to prohibit). Certain other changes are highlighted below.

- Predictions and projections of performance. The new rules carry forward the current prohibition of performance predictions and projections, as well as the allowance for hypothetical illustrations of mathematical principles. The rules clarify, however, that two additional types of performance projections are permitted: (1) projections of

performance in reports produced by investment analysis tools that meet the requirements of new Rule 2214 (discussed below); and (2) research reports on debt or equity securities that include price targets, if certain additional requirements are met.

- Disclosure of a firm's name. The new rules apply the standards for disclosure of a firm's name to correspondence and retail communications, rather than just to advertisements and sales literature.
- Tax considerations. The new rules carry forward existing requirements for information that must be provided in advertisements and sales literature that include references to tax-free or tax-exempt income. Under the new rules, however, the requirements apply to all retail communications and correspondence. The prohibition on characterizing income or investment returns as tax-free or tax-exempt when tax liability is merely postponed or deferred is carried forward for all communications. The new rules contain new language—largely based on previous FINRA guidance—concerning comparative illustrations of the mathematical principles of tax-deferred versus taxable compounding.
- Testimonials. The new rules generally track current requirements. The requirement to disclose that a testimonial is a paid testimonial will apply if more than \$100 in value (rather than a “nominal sum”) is paid.
- Recommendations. The new rules revise in several ways current standards applicable to communications that contain a recommendation. For example, the scope of required disclosure of certain conflicts of interest will be narrowed. [\[13\]](#) In addition, the new standards governing communications that include past recommendations mirror the requirements of Rule 206(4)-1(a)(2) under the Investment Advisers Act of 1940, applicable to investment adviser advertisements containing past recommendations. Like Rule 206(4)-1(a)(2), the new rules generally prohibit retail communications from referring to past specific recommendations of the firm that were or would have been profitable to any person. They permit a retail communication or correspondence to set out or offer to furnish a list of all recommendations as to the same type, kind, grade or classification of securities made by the firm within the immediately preceding period of not less than one year. The list must provide certain information regarding each security and a prescribed cautionary legend. The new rules expressly exclude communications that meet the definition of a “research report” for purposes of NASD Rule 2711 and that include disclosures required by that rule. Also excluded are communications that recommend only registered investment companies or variable insurance products, provided that such communications have a reasonable basis for the recommendation.

## **Public Appearances (Rule 2210(f))**

Under the new rules, “public appearance” is no longer a separate communication category but many of the same general standards that currently apply to public appearances will continue to apply. If an associated person recommends a security in a public appearance, the associated person must have a reasonable basis for the recommendation and must disclose, as applicable: (1) that the associated person has a financial interest in any of the securities of the issuer whose securities are recommended, and the nature of the financial interest, unless the extent of the financial interest is nominal; and (2) any other actual, material conflict of interest of the associated person or firm of which the associated person knows or has reason to know at the time of the public appearance. These requirements regarding recommendations do not apply to any public appearance by a research analyst for purposes of NASD Rule 2711 that includes all applicable disclosures required by that rule. They also do not apply to a recommendation of investment company securities or

variable insurance products, provided that the associated person has a reasonable basis for the recommendation. Firms must establish written policies and procedures to supervise public appearances, and the scripts, slides, handouts or other written (including electronic) materials used in connection with public appearances are considered communications for purposes of FINRA Rule 2210.

## **Use of Investment Company Rankings in Retail Communications (Rule 2212)**

FINRA Rule 2212 replaces current NASD interpretive material regarding standards applicable to the use of investment company rankings, but it generally maintains the same standards. In a change from current standards, however, investment company rankings for more than one class of an investment company with the same portfolio must be accompanied by prominent disclosure that the investment companies or classes have different expense structures. Rule 2212 excludes reprints of articles or reports that are excluded from filing requirements (see above).

## **Requirements for the Use of Bond Mutual Fund Volatility Ratings (Rule 2213)**

FINRA Rule 2213 replaces current NASD interpretive material regarding standards applicable to the use of bond mutual fund volatility ratings in communications. The standards remain the same.

## **Requirements for the Use of Investment Analysis Tools (Rule 2214)**

FINRA Rule 2214, along with Supplementary Material to the rule, replaces current NASD interpretive material regarding standards applicable to the use of investment analysis tools. The standards generally remain the same.

## **Guidelines for Communications with the Public Regarding Security Futures (Rule 2215)**

FINRA Rule 2215 replaces current NASD interpretive material regarding standards applicable to communications concerning security futures. It revises current standards in several respects. For example, portions of the current standards apply only to advertisements; Rule 2215 applies these provisions to all retail communications.

## **Communications with the Public About Collateralized Mortgage Obligations (Rule 2216)**

FINRA Rule 2216 replaces current NASD interpretive material regarding standards applicable to retail communications concerning collateralized mortgage obligations. The standards remain the same.

**endnotes**

[1] See Securities Exchange Act Release No. 66681 (March 29, 2012), 77 Fed. Reg. 20452 (April 4, 2012).

[2] See FINRA Regulatory Notice 12-29 (June 2012) (“Notice”), available at [www.finra.org/notices/12-29](http://www.finra.org/notices/12-29). The rule text is available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/industry/p127016.pdf>.

[3] Incorporated NYSE Rules apply to FINRA members that are also members of the New York Stock Exchange.

[4] “Retail investor” is defined as “any person other than an institutional investor, regardless of whether the person has an account with a member.”

[5] The Notice notes that under the new rules a firm still may supervise retail communications that fall within the current definition of “market letter” in the same manner as correspondence, provided that the communication does not make any financial or investment recommendation.

[6] The definition of “institutional investor” has been modified to clarify that it includes multiple employee benefit plans and multiple qualified plans offered to employees of the same employer, provided that the plans in the aggregate have at least 100 participants.

[7] The Notice emphasizes that even though internal communications are excluded, firms still must supervise these communications under NASD Rule 3010.

[8] See NASD Rule 2211(a)(3); FINRA Rule 2210(a)(4).

[9] In addition, the new rules require that an appropriately qualified principal must approve any communication that is filed with FINRA, regardless of whether the communication otherwise would come under an exception to the principal pre-use approval requirements. See FINRA Rule 2210(b)(1)(F).

[10] FINRA Rule 2210(b)(4)(A) incorporates by reference the recordkeeping format, medium and retention period requirements of Rule 17a-4 under the Securities Exchange Act of 1934.

[11] In many cases, the modifications simply involve the re-categorization of communications under the new rules (e.g., filing exclusions that previously applied to advertisements and sales literature have been extended to all retail communications meeting the applicable standards for exclusion).

[12] The Notice notes that FINRA requires firms to file the Management’s Discussion of Fund Performance (MDFP) and any non-required sales material contained in mutual fund shareholder reports if a firm intends to use the reports to market the fund to prospective investors.

[13] Currently, a firm must disclose if the firm’s officers or partners have a financial

interest in the securities of the recommended issuer and the nature of the financial interest, unless the extent of the financial interest is nominal. The new rules require disclosure, if applicable, that the firm or any associated person directly and materially involved in the preparation of the content has a financial interest in any of the securities of the issuer whose securities are recommended, and the nature of the financial interest, unless the extent of the financial interest is nominal.

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