The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 25791

January 11, 2012

ICI Draft Letter on Proposed Amendments to FINRA Advertising Rules; Comments Due to ICI by January 17th

URGENT/ACTION REQUESTED

[25791]

January 11, 2012

TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 3-12
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 4-12 RE: ICI DRAFT LETTER ON PROPOSED AMENDMENTS TO FINRA ADVERTISING RULES; COMMENTS DUE TO ICI BY JANUARY 17TH

As we previously informed you, the Securities and Exchange Commission ("SEC") published for comment an additional amendment filed by the Financial Industry Regulatory Authority ("FINRA") to revise its advertising rules. [1] The new rules would replace current NASD Rules 2210 and 2211, the Interpretive Materials that follow NASD Rule 2210, and portions of NYSE Rule 472 and related interpretive material.

Comments on the proposal must be filed with the SEC by January 18th. The Institute has prepared the attached draft comment letter, which is summarized below. If you have any comments on the draft letter, please provide them as soon as possible, but no later than January 17th, to Dorothy Donohue by email (ddonohue@ici.org) or phone at (202) 218-3563. In particular, please let me know how frequently, in general terms, FINRA comments on your shareholder reports (e.g., never, almost never, sometimes, always).

Shareholder Reports

The draft letter states that under the Proposed Final Rule, FINRA would maintain the current requirement that member firms file the Management's Discussion of Fund Performance ("MDFP") and any other sales material included in a fund's annual and semi-annual shareholder reports ("shareholder reports") if a member firm intends to use the shareholder reports as sales material with prospective investors. It notes that the Institute discussed at length in a prior comment letter why layering FINRA filing and content requirements on top

of the Securities and Exchange Commission's content and filing requirements and member firms' internal review processes and procedures would subject funds to duplicative, costly, and unnecessary oversight.

The draft letter states that FINRA did not make the recommended change, reasoning that it reviews shareholder reports more frequently than the Commission does, and such review "does not impose a large burden on members relative to the benefit to investors by ensuring that the MDFP is fair, balanced, and accurate."

The draft letter states that we do not disagree that, as a general matter, FINRA review of fund retail communications helps to ensure that these communications are fair, balanced, and accurate. However, the unique requirements that apply to shareholder reports distinguish them from other categories of fund retail communications and negate the need for FINRA review. It then discusses those requirements, including Commission filing and content requirements, certification requirements, and auditor review.

The draft letter points out that FINRA has recognized in other contexts that filing sales material with FINRA is unnecessary given the existence of other protections. In particular, proposed Rule 2210 provides exclusions from filing for fourteen different types of communications, the most analogous to shareholder reports being the exclusion for prospectuses, preliminary prospectuses, fund profiles, offering circulars and similar documents that have been filed with the Commission.

The draft letter also points out that filing shareholder reports with FINRA entails significant costs. One Institute member reports that it costs approximately $36,000 annually in filing fees despite having only received one comment in over ten years. The draft letter estimates that a significant number of Institute member firms pay more than $20,000 in fees annually to file shareholder reports with FINRA.

The draft letter states that for these reasons, we strongly urge FINRA to reconsider the need for the current filing requirement, particularly when balanced with the associated filing costs.

Reason to Believe Standard

The draft letter notes that under both current Rule 2211 and the Proposed Final Rule, the definition of "institutional investor" provides 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." FINRA provided as an example in its December letter to the Commission responding to comments that firms may wish to get periodic assurances from institutional investors that they will not forward institutional communications to retail investors.

The draft letter notes that many funds are sold through intermediary broker-dealer firms, and the intermediary firm may use institutional communications prepared by the fund's principal underwriter with its associated persons. In these circumstances, we believe that that it would be the recipient broker-dealer that would be responsible for assuring that its associated persons limit use of the communication to institutional investors. This is a practical approach that responds to FINRA's regulatory concerns without creating duplicative compliance burdens. It also would be consistent with FINRA's approach in another context where an intermediary firm uses sales material prepared by a fund underwriter. The draft letter requests that FINRA clarify this in any regulatory notice

accompanying any final rules.

Dorothy M. Donohue
Senior Associate Counsel

Attachment

endnotes

[1] See Institute Memorandum No.25769, dated January 5, 2012.
