Communications Compliance: Current Developments
Tuesday, May 17, 2022
9:45 a.m. – 10:45 a.m.

Join FINRA staff and industry panelists for a discussion of current communications compliance and marketing practices. Topics include recent guidance on how FINRA's communications rules apply in a virtual environment, and how firms can communicate compliantly about ESG and other current investment trends. Panelists also talk about the regulatory implications of complex products and services such as crypto assets and emerging technologies in the marketing compliance space.

Moderator:

Ira Gluck
Director
FINRA Advertising Regulation

Panelists:

Suzanne Bond
Senior Vice President and Chief Compliance Officer
Inland Securities Corporation

Pramit Das
Director
FINRA Advertising Regulation

Sheelagh Howett
Chief Risk Officer and Chief Compliance Officer
Cantella & Co., Inc.

Communications Compliance: Current Developments Panelists Bios:

Moderator:

Ira Gluck is Director in FINRA's Advertising Regulation Department. In this role, he works on rulemaking and policy issues and is responsible for the Department's complex review and spot-check programs. Mr. Gluck's previous positions within FINRA included leading the Emerging Regulatory Issues team as well as heading the Strategic Initiatives Group in FINRA's Enforcement Department. He also served in various investigative and management roles in the Enforcement and Member Regulation Departments of NASD before its 2007 consolidation with NYSE Member Regulation, which resulted in the formation of FINRA. Mr. Gluck received his bachelor's degree from the University of Pennsylvania and completed both a master's degree and M.B.A. at the University of California, Irvine.

Panelists:

Suzanne L. Bond is a highly regarded Chief Compliance Officer with a demonstrated track record for over 25 years in various sectors of the financial services industry. She began her career with a national wire house in fixed income and futures, and further expanded her expertise across regional and independent broker/dealers, and registered investment advisory firms where she has held positions in sales, marketing and compliance. In her current role as Senior Vice President, Chief Compliance Officer of Inland Securities Corporation, the affiliated dealer/manager of Inland Real Estate Investment Corporation, Ms. Bond contributes her skills in areas of business governance and risk management, investment management practices, alternative investment markets, and compliance management. She is a strong influencer to senior business stakeholders, assisting with strategic planning, operational procedure, employee compensation, and technology systems development. Prior to joining Inland, Ms. Bond served as Vice President and Director of Supervision for the Capital Markets Group at Wedbush Securities. Prior to that, she served as Chief Compliance Officer for a number of independent broker/dealers and investment advisory firms, both retail and institutional. In January 2020, Ms. Bond was appointed to the Financial Industry Regulatory Authority ("FINRA") Midwest Region Committee for a three-year term. She is a frequent panelist/guest speaker at national industry events including the inaugural SEC Compliance Outreach Program. Ms. Bond holds a B.S. in International Business from Union Institute & University and a Master of Jurisprudence, Business Law from Loyola University Chicago. She is fluent and/or conversant in six languages, and holds FINRA Series 7, 24, 63, 66, 79, and 99 licenses.

Pramit Das is Director in FINRA's Advertising Regulation Department. In this role, his responsibilities include managing the Department's filings review program, operations, administration and, proprietary technology systems. He also provides education to members, FINRA staff and other regulatory staff and, participates in rule amendment and rulemaking projects as necessary. Prior to joining FINRA (fka NASD) in 1994, Mr. Das worked for Metropolitan Life Insurance Company and Arthur Andersen & Co. He holds an MBA in Finance from the University of Maryland, College Park, and an MA in Financial Economics from Clemson University, Clemson, South Carolina. He was also Series 7 and 63 registered.

Sheelagh Howett is Chief Risk Officer and Chief Compliance Officer at Cantella & Co., Inc. She is on the Board of Directors and shares leadership responsibility with the executive management team for overseeing the growth and success of the firm. She focuses on keeping clear and regular communication between business units and compliance within the firm. She strongly believes that risk is an enterprise-wide responsibility and has created a risk-aware culture including an understanding that risk prevention is everyone's job. She continually works to further develop risk-management processes to identify, assess, and respond to the inevitable risks that face our industry. At the same time, she works to improve the efficiency and integration of existing processes into daily routines, so they become ingrained in the firm's business. Ms.

Howett is a member of the New England Broker/Dealer Investment Advisor Association, and the Women in Pensions Network. Originally from Ireland, Ms. Howett earned a BA in Banking and Finance at University College in Dublin. She holds FINRA Series 7 and 24 licenses.

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Panelists

- **Moderator**
  - Ira Gluck, Director, FINRA Advertising Regulation
- **Panelists**
  - Suzanne Bond, Senior Vice President and Chief Compliance Officer, Inland Securities Corporation
  - Pramit Das, Director, FINRA Advertising Regulation
  - Sheelagh Howett, Chief Risk Officer and Chief Compliance Officer, Cantella & Co., Inc.

Agenda

- Compliance in a Virtual Environment
- Current Issues
- Emerging Technologies and Digital Communications
- Questions
- Wrap-up

01 | Compliance in a Virtual Environment

Compliance in a Virtual Environment

- Compliance Program Changes
- Hybrid Work Environments
- FINRA FAQ

02 | Current Issues

Current Issues

- Crypto Assets
- Complex Products
- ESG

03 | Emerging Technologies and Digital Communications

Emerging Technologies and Digital Communications

- New Digital Platforms
- Video
- Firm Approaches to Digital Communications
- FINRA Observations
- Working with FINRA Staff
- Emerging Concerns

04 | Questions


Q
A

05 | Wrap-up

Frequently Asked Questions About Advertising Regulation

On This Page

FINRA Rule 2210 Interpretive Guidance

A. Definitions

A.1. Institutional Communications

A.1.1. Q. If a firm distributes an institutional communication to intermediaries that fall within the definition of "institutional investor" and labels the communication for use only with institutional investors, and an intermediary subsequently distributes the communication to retail investors, is the member then required to treat the communication as a retail communication?

A. Unless the firm becomes aware that the intermediary has distributed the communication to retail investors, or the firm has not adequately labeled the communication, the firm will not be required to treat the communication as retail. FINRA Rule 2210(a)(3) defines "institutional communication" as "any written (including electronic) communication that is distributed or made available only to institutional investors, but does not include a member's internal communications." FINRA Rule 2210(a)(4) (the definition of "institutional investor") states in part that "No 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."

For example, a broker-dealer that receives an institutional communication from a mutual fund underwriter is responsible for assuring that its associated persons do not forward the communication to retail investors. The "reason to believe" standard is not intended to require a mutual fund underwriter to audit recipient broker-dealers' use of institutional communications.

Assuming a firm adequately labels an institutional communication as being for institutional use only, the firm would not have reason to believe, absent other facts, that the communication will be distributed to retail investors. However, if the recipient broker-dealer informs the fund underwriter that it intends to distribute the communication to its retail customers, or the fund underwriter otherwise becomes aware of this practice, the fund underwriter must either treat the communication as a retail communication going forward, or cease distributing institutional communications to the recipient broker-dealer until it reasonably concludes that the broker-dealer has adopted appropriate procedures to prevent redistribution.

Posted: 5/22/15

A.1.2. Q. FINRA Rule 2210(a)(3) defines "institutional communication" to exclude a firm's internal communications. Does "internal communication" include training and educational material prepared for use with registered representatives of affiliated broker-dealers?

A. No. "Internal communication" refers to communications within a firm. If a firm uses material to train or educate registered representatives of other broker-dealers (whether affiliated or unaffiliated), the material would be considered an institutional communication.

Posted: 1/7/13

B. Principal Approval

B.1. Third Party Research Reports

B.1.1. Q. If a firm distributes only to institutional investors a third-party research report that does not qualify as an independent third-party research report pursuant to FINRA Rule 2241(a)(3), is the firm required to have a registered principal or supervisory analyst approve the report prior to distribution?

A. No. A third-party research report that is distributed only to institutional investors as defined in FINRA Rule 2210(a)(4) is considered an institutional communication under FINRA Rule 2210(a)(3). FINRA Rule 2210(b)(3) permits a firm to distribute an institutional communication without having a registered principal approve the communication prior to distribution, provided that the firm establishes and implements certain written procedures for the supervision and review of such communications.

FINRA Rule 2241(h)(1) requires a registered principal or supervisory analyst to review for compliance with the applicable provisions of Rule 2241(h) and approve third-party research reports distributed by the firm unless the report meets the definition of "independent third-party research report."[1] However, this rule is not intended to require registered principal or supervisory analyst approval of a third-party research report that meets the definition of institutional communication. Accordingly, a firm may supervise such a report in the same manner as any other institutional communication pursuant to FINRA Rule 2210(b)(3).[2]

Updated: 12/14/15

B.2. Business Development Companies

B.2.1. Q. Does a Series 26 registration (Limited Principal - Investment Company and Variable Contracts Products) qualify a principal to approve a retail communication concerning a BDC?

A. No. A BDC is not registered as an investment company under the Investment Company Act of 1940. Accordingly, the Series 26 registration does not qualify a principal to approve a retail communication concerning a BDC. To approve a retail communication concerning a BDC, the registered principal must possess either a Series 24 (General Securities Principal), a Series 9/10 (General Securities Sales Supervisor) or a Series 39 (Limited Principal - Direct Participation Programs) registration, if the BDC is structured as a direct participation program as defined in NASD Rule 1022(e)(2).[3]

Posted: 5/22/15

B.3. Questions concerning principal approval of non-promotional communications (see Section C.4.) and for social media posts in online interactive electronic forums (see section C.6.).

C. Filing Requirements and Filing Exclusions

C.1. Filing Requirements

C.1.1. Q. Is a firm required to file with FINRA a retail communication concerning a business development company (BDC) that is registered under the Securities Act?
A. Yes. BDCs fall within the definition of direct participation program under FINRA Rule 2310(a)(4). Accordingly, firms must file with FINRA retail communications concerning BDCs that are registered under the Securities Act within 10 business days of first use or publication pursuant to FINRA Rule 2210(c)(3)(B).

Posted: 5/22/15

C.1.2. Q. FINRA Rule 2210(c)(3)(E) requires a firm to file within 10 business days of first use or publication retail communications concerning any security that is registered under the Securities Act of 1933 and that is derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance or a foreign currency (registered structured products). What types of products does this filing requirement cover?
A. While it is not possible to list all registered structured products, examples include exchange-traded notes that are not registered under the Investment Company Act but are registered under the Securities Act, registered reverse convertibles, registered structured notes, registered principal protection notes, and any other registered security that includes embedded derivative-like features. See Regulatory Notice 12-03 for some examples of registered structured products.

The purpose of this filing requirement is to have firms file with FINRA retail communications about structured products that are registered under the Securities Act. It is not intended to create a duplicative requirement for retail communications that are already subject to filing, such as retail communications concerning mutual funds, closed-end funds, exchange-traded funds that are registered under the Investment Company Act, variable insurance products, direct participation programs or collateralized mortgage obligations.

While this filing requirement applies to retail communications concerning registered structured products, it does not apply to issuer-prepared prospectuses, including issuer-prepared free-writing prospectuses that are filed with the SEC.[4]

Posted: 1/7/13

C.2. Filing Exclusion for Non-Material Changes to Previously Filed Retail Communications

C.2.1. Q. If a firm has previously filed a retail communication and then decides to use the same communication in a different format, must the firm refile the communication as it appears in the new format?
A. No. FINRA Rule 2210(c)(7)(A) excludes from filing retail communications that previously have been filed with FINRA and that are used without material change. FINRA would not consider revising a retail communication to appear in a different format to be a material change, provided that the content has not materially changed. For example, if a firm has previously filed a retail communication in the format that it appears on a desktop or laptop computer, and the firm is redesigning the presentation to appear on a tablet or smart phone, the firm would not have to refile the version that will appear on a tablet or smart phone.

Posted: 5/22/15

C.2.2. Q. What if a firm uses responsive Web design technology[5] to deliver a retail communication in different formats depending on the device used by a customer? Must the firm file each version of the retail communication to show how it will appear on each device?
A. No. For the same reasons set forth in the answer to the previous question, FINRA would not consider delivery of the same content in a retail communication in different formats using responsive design technology to be a material change to the communication. Accordingly, a firm would only have to file the retail communication once.

Posted: 5/22/15

C.2.3. Q. If a firm previously filed a retail communication that was initially distributed in print form, and the firm later decides to post the same communication on its website, must the firm refile the website version of the retail communication with FINRA?
A. No, provided that the content of the website version of the retail communication appears without material change from the previously filed print version.

Posted: 5/22/15

C.2.4. Q. If a firm changes the color scheme of a previously filed retail communication, must the firm refile the new version of the retail communication?

A. No. FINRA would not regard merely changing the color scheme of a previously filed retail communication to be a material change to the communication.

Posted: 5/22/15

C.2.5. Q. Is a firm required to re-file retail communications concerning a mutual fund that changes its name, if the only changes to the previously filed communications are substitutions of the fund's new name for its old name?
A. No. Assuming the fund has changed its name in any required filings with the SEC, FINRA would not consider merely changing the fund's name from previously filed retail communications concerning the fund to be a material change to the communications.

Posted: 5/22/15

C.2.6. Q. If a mutual fund passes its five-year or ten-year anniversary since inception, and a firm adds a new line to previously filed retail communications that present fund performance to show the fund's five-year or ten-year performance record as required by SEC Rule 482, must the firm re-file the revised retail communications?
A. No. FINRA would not consider merely adding a fund's five-year or ten-year performance record as required by Rule 482 to previously filed retail communications to be a material change.

Posted: 5/22/15

C.2.7 Q. The SEC presumes that the use of the terms “adviser” or “advisor” in a name or title by a broker-dealer that is not also registered as an investment adviser, or an associated person that is not also a supervised person of an investment adviser, to be a violation of the capacity disclosure requirement under Regulation Best Interest. If a firm previously filed a retail communication with FINRA, but now needs to revise the communication to eliminate references to adviser or advisor in the firm’s name or an associated person’s title because of Regulation Best Interest’s presumption, would the firm be required to re-file the communication with FINRA?
A. No. Provided that the only revisions to the previously filed retail communication are eliminating references to adviser or advisor in order to comply with Regulation Best Interest, the firm would not be required to re-file the communication. Under these facts, FINRA would not consider such revisions to be a material change.

Posted: 5/20/20

C.3. Filing Exclusion for Templates

C.3.1. Q. A firm acts as a principal underwriter of a mutual fund family, and each fund in the family offers multiple classes of shares. If the firm creates a separate fact sheet for each share class of every fund in the family, is the firm required to file every fact sheet with FINRA if the only differences between the fact sheets for each share class of a particular fund are a share class's sales load, fees and performance?
A. No. FINRA Rule 2210(c)(7)(B)(i) excludes from filing retail communications that are based on templates that were previously filed with FINRA the changes to which are limited to updates of more recent statistical or other non-narrative information. If a firm files fact sheets for all share classes of one fund in its fund family, and the share class fact sheets for other funds follow the same format in presenting sales load, fee and performance information, then the firm would not be required to file the fact sheet for each share class of the other funds in the family. Instead, pursuant to the filing exclusion for templates, the firm would be permitted to file the fact sheet for only one share class of each of the other funds in the fund family. The firm should indicate as part of its filing that it is relying on the filing exclusion for templates in cases where the firm is filing only one share class fact sheet for a particular fund.[6]

Posted: 5/22/15

C.4. Non-Promotional Communications

C.4.1. Q. Is a firm required to file with FINRA, or have a principal approve prior to use, a retail communication that is limited to market commentary concerning overall changes in the market on a particular day, or a discussion of economic news?
A. No. General market commentaries or economic discussions that are not used for the purpose of promoting a product or service of the firm would be considered retail communications that do not make any financial or investment recommendation or otherwise promote a product or service of the member. See FINRA Rules 2210(b)(1)(D)(iii) and 2210(c)(7)(C).

Posted: 5/22/15

C.4.2. Q. Is a firm required to file, or have a principal approve prior to use, a retail communication that merely explains factual information regarding an individual retirement account, qualified plan or 401(k) account?
A. No. These kinds of retail communications also would be considered to be non-promotional and thus not subject to the principal pre-use approval or filing requirements. See FINRA Rules 2210(b)(1)(D)(iii) and 2210(c)(7)(C).

Posted: 5/22/15

C.4.3. Q. Is a firm required to file, or have a principal approve prior to use, a retail communication that merely provides information to participants in an employee retirement plan as required by the Employee Retirement Income Security Act of 1974 (ERISA) or the current Department of Labor (DOL) rules under ERISA? For example, would a firm be required to file a retail communication that merely informs participants in an employee retirement plan of changes to the investment options that are available through the plan?

A. In most cases, no. A firm would not be required to file or have a principal approve prior to use a notice distributed to plan participants that is required by ERISA or DOL rules, such as a notice that merely informs the participants of investment options that will no longer be available through the plan as of a particular date, and the investment options that will replace the eliminated options.

FINRA would consider such a notice to be a retail communication that does not make any financial or investment recommendation or otherwise promote a product or service of the member. However, if the notice also includes performance or other information that describes the investment objectives of the new investment options, or otherwise includes a headline or other graphic or text that promotes these new options, the firm would be required to file the notice, unless this information is required by ERISA or DOL rules.[7]

Posted: 5/22/15

C.4.4. Q. Is a firm required to file its stationery or the business cards of its associated persons?

A. No. These communications are not subject to filing requirements.

Posted: 5/22/15

C.4.5. Q. Is a firm required to have a principal approve prior to use or file with FINRA a video posted online that does not recommend or promote a product or service of the firm? New

A. No. In accordance with the exceptions in FINRA Rules 2210(b)(1)(D)(iii) and (c)(7)(C), a firm is not required to have a principal approve prior to use or file with FINRA a video posted online that does not recommend or promote a product or service of the firm, provided that the firm supervises and reviews such videos in the same manner as correspondence pursuant to FINRA Rules 3110(b) and 3110.06 through .09.[8] For example, FINRA Rule 3110(b)(4) requires that a firm's written supervisory procedures include procedures for the review of electronic communications related to the firm's investment banking or securities business and such procedures must be appropriate for each firm's business, size, structure, and customers.

Posted: 9/30/21

C.5. Article Reprints

C.5.1. Q. If a firm wishes to distribute to its customers a reprint of an article concerning a product subject to one of the filing requirements that appeared in an unaffiliated magazine or newspaper, and the only change that the firm made to the article was to add the firm's name and any disclosures necessary to meet applicable regulatory standards, is the firm required to file the article reprint with FINRA?

A. No. If a firm merely adds its name to the reprint or adds disclosures required to make the reprint consistent with applicable regulatory standards, the firm is not required to file the reprint with FINRA pursuant to FINRA Rule 2210(c)(7)(I).[9]

Posted: 5/22/15

C.6. Social Media Posts in Online Interactive Electronic Forums

C.6.1. Q. Did the adoption of FINRA Rule 2210 change the exceptions from the principal pre-use approval and filing requirements for posts in the interactive electronic forum portions of social media as compared to the requirements under NASD Rule 2210?

A. No, these exceptions have not changed. NASD Rule 2210 included as a communication category public appearances, which was defined to include participation in an interactive electronic forum. NASD Rule 2210 did not require principals to approve public appearances prior to use, and did not require firms to file public appearances with FINRA.

FINRA Rule 2210 treats interactive electronic forum posts, such as social media status updates, as retail communications rather than public appearances; however, the rule specifically excludes these posts from both the principal pre-use approval requirements and the filing requirements. See FINRA Rules 2210(b)(1)(D)(ii) and 2210(c)(7)(M). Accordingly, these exceptions have not changed with respect to posts on interactive electronic forums, despite the fact that they are no longer considered public appearances for purposes of the rule.[10]

Posted: 5/22/15

D. Content Standards

D.1. Disclosure of Expense Reimbursement Arrangements in Mutual Fund Performance Advertising

D.1.1. Q. If a firm presents mutual fund performance information in a retail communication, and the fund's expenses are subsidized through a fee waiver or expense reimbursement arrangement, must the firm disclose this arrangement?

A. FINRA Rule 2210(d)(5)(A) requires retail communications and correspondence that present non-money market fund open-end management investment company performance data as permitted by Securities Act Rule 482 and Investment Company Act Rule 34b-1 to disclose, among other things, the fund's total annual operating expense ratio, gross of any fee waivers or expense reimbursements, as stated in the fund's prospectus fee table.

FINRA also permits a firm to present in performance communications the fund's subsidized expense ratio, as long as the firm presents both the gross and subsidized expense ratios in a fair and balanced manner. If a firm wishes to present a fund's subsidized expense ratio in correspondence or retail communications, the communication must disclose whether the fee waivers or expense reimbursements were voluntary or mandated by contract, and the time period, if any, during which the fee waiver or expense reimbursement obligation remains in effect.[11]

Posted: 5/22/15

D.1.2. Q. May a retail communication or correspondence concerning a mutual fund also include an “adjusted expense ratio” that illustrates the impact of interest and dividend expenses incurred by the fund from borrowings, repurchase agreements or investments in short sales?

A. Yes. Because interest and dividend expenses incurred from borrowings, repurchase agreements or investments in short sales (whether directly or through investments in underlying funds) are considered fund expenses under generally accepted accounting principles, they must be included in a fund’s gross and net expense ratios disclosed in the prospectus fee table. Provided that the communication includes the fund’s gross and net expense ratios, it also may include an “adjusted expense ratio” that is the fund’s gross expense ratio reduced by any amounts contractually waived or reimbursed, and further reduced by interest and dividend expenses resulting from borrowings, repurchase agreements or investments in short sales. The communication should clearly label, and include a prominent plain English explanation of, the adjusted expense ratio, which should be presented separately from, and with no greater prominence than, the fund’s gross and net expense ratios.

Posted: 12/2/19

D.2. Recommendations

D.2.1. Q. Do the disclosure requirements regarding recommendations apply to a mutual fund portfolio manager's discussion of the fund's past performance (such as a manager's discussion that accompanies an annual or semi-annual report)?

A. No. While these discussions must comply with FINRA Rule 2210, FINRA does not consider a portfolio manager's discussion of a fund's past performance to be a firm's recommendation of the individual securities included in the discussion.

Posted: 1/7/13

D.3. Provision of Related Performance Information

D.3.1. Q. FINRA’s letter to Edward P. Macdonald, Hartford Funds Distributors, LLC (“Hartford”), dated May 12, 2015 (“Hartford Letter”) interpreted FINRA Rule 2210 to allow Hartford to include Related Performance Information in communications concerning mutual funds that are distributed solely to institutional investors, as that term is defined in FINRA Rule 2210(a)(4), subject to enumerated representations and conditions. Provided that the presentation is consistent with the representations and conditions contained in the Hartford Letter, may a firm show Related Performance Information that is net of the fees and expenses of the advertised mutual fund?

A. Yes. In condition 5 of the Hartford Letter, Hartford represented that the presentation of Related Performance[12] Information will disclose performance information that is net of fees and expenses of Related Accounts[13], or net of a model fee that is the highest fee charged to any account managed in the strategy. Condition 5 also stated that the fees and expenses of the registered fund that is the subject of the institutional communication will be prominently disclosed and this fund’s performance will reflect all fees and expenses. Condition 5 also stated that if the registered fund’s fees and expenses are higher than the Related Accounts’ fees and expenses, that fact will be disclosed.

A presentation of Related Performance Information that is net of all fees and expenses of the registered mutual fund that is the subject of an institutional communication, rather than the fees and expenses of the Related Accounts, is consistent with the intent of the Hartford Letter. The institutional communication must prominently disclose the fact that the Related Performance Information is shown net of the registered fund’s fees and expenses and, if applicable, that the registered fund’s fees and expenses are lower than those of the Related Accounts.

Posted: 3/9/17

D.3.2. Q. Is the Hartford Letter intended to allow the presentation of Related Performance Information in an institutional communication concerning an actively managed exchange-traded fund (“ETF”) that is registered under the Investment Company Act of 1940?

A. Yes. A firm may present Related Performance Information in an institutional communication concerning an actively managed ETF, provided that this presentation is consistent with the representations and conditions contained in the Hartford Letter.

Posted: 3/9/17

D.4. Usability Study and Focus Group Communications

D.4.1. Q. If a firm distributes a communication solely for the purposes of recruiting individuals who might be part of a group to provide feedback or participate in a usability study (through a focus group or otherwise), or solely for the purposes of communicating a "blind" or anonymous survey, must the firm disclose its member name under Rule 2210(d)(3) in the communication?
A. No. Rule 2210(d)(3) expressly states that it does not apply to "blind" advertisements used to recruit personnel. Similarly, it would not apply in these recruiting and feedback situations in which using a member name would counteract the purpose of the communication.

Posted: 1/16/19

D.4.2. Q. If a firm distributes a communication solely to one or more individuals who are engaged to provide feedback concerning the communication or participate in a usability study concerning the communication (through a focus group or otherwise), and those individuals are informed that the communication is being provided solely for such purpose, would that communication be subject to Rule 2210 and its requirements?
A. No.

Posted: 1/16/19

D.5. Use of Hyperlinks in Electronic Communications New

D.5.1. Q. Does FINRA Rule 2210(d)(1)(A) permit a firm to include in electronic communications hyperlinks to content that provides additional information related to the communication in a fair and balanced manner?
A: Yes. FINRA Rule 2210(d)(1)(A) requires firm communications, among other things, to be fair, balanced, and not to omit any material fact or qualification if the omission would cause the communication to be misleading. Consistent with these standards, a firm may rely on a hyperlink to provide additional information or explanations so long as the initial electronic communication that includes the link is itself fair and balanced. For example, a non-misleading electronic communication about opportunities in emerging markets could link to an additional explanation about the basis for a claim in the initial post as well as the risks associated with emerging markets investments. However, a firm may not rely on linked explanations or disclosures to correct a communication that is, on its face false, misleading, exaggerated or promissory. [14] To the extent practicable in the given medium, the link itself, or the text within the communication that introduces the link, should state what will be provided through the link.

Historically, FINRA has interpreted the Communications with the Public Rules to permit hyperlinks to explanations and further information in a variety of situations. For example, FINRA Rule 2210 permits firms to use hyperlinks within banner advertisements to generate interest in a topic and provide more information through hyperlinks, [15] and FINRA has interpreted FINRA Rule 2210 to permit firms to link to required information about testimonials.[16]

This approach is also consistent with the treatment of hyperlinks in the Commission's recently adopted Investment Adviser Marketing rule under the Investment Advisers Act of 1940. [17] The Marketing Rule Adopting Release notes that the rule's use of "fair and balanced" is closely aligned with FINRA Rule 2210's general standards, and that investment advisers may use layered disclosure that employ hyperlinks to meet these requirements. [18]

Posted: 9/30/21

D.6. Internal Rate of Return (IRR) New

D.6.1. Q. Regulatory Notice 20-21 (FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings) interprets FINRA Rule 2210 to permit the inclusion of an internal rate of return (IRR) if it is calculated in a manner consistent with the Global Investment Performance Standards (GIPS®) adopted by CFA Institute and includes additional GIPS-required metrics such as paid-in capital, committed capital and distributions paid to investors. What is the distinction between calculating IRR in a "manner consistent with the GIPS standards" and "GIPS compliance"?
A. The guidance in *Regulatory Notice 20-21* that IRR be calculated in a "manner consistent with the Global Investment Performance Standards (GIPS)" refers to using the same primary inputs and calculation methodology articulated in the GIPS standards as well as including prominently in the communication the additional required metrics set forth in the GIPS standards. The primary inputs are external cash flows and the period-end value of the investment or terminal value. With respect to the calculation methodology, since-inception IRR can be calculated using common spreadsheet software and the extended IRR (XIRR) function. [19]

Firms that comply with all of the applicable requirements of the GIPS standards on a firm-wide basis may claim compliance with the GIPS standards (i.e., they are "GIPS compliant"). Firms are not required to claim compliance with GIPS or choose to have their firm verified in order to use IRR in private placement communications in a manner that is consistent with the requirements of FINRA Rule 2210.

While the GIPS standards generally prohibit firms from making any statement referring to the calculation methodology as being "in accordance," "in compliance," or "consistent" with the GIPS standards, CFA Institute has created a limited exception for firms and their agents in retail communications concerning private placement offerings that are prepared in a manner consistent with FINRA Rule 2210 and the guidance in *Regulatory Notice 20-21*. [20]

It is also important to recognize that the requirement to present IRR calculated in a "manner consistent with the Global Investment Performance Standards (GIPS)" only applies to investment programs with ongoing operations that include a combination of realized and unrealized holdings.

When presented in a fair and balanced manner, realized historical performance for a completed investment program, whether expressed as IRR or any other return metric, will generally be consistent with the content standards in FINRA Rule 2210. In contrast, as stated in *Regulatory Notice 20-21*, IRR presented for privately placed new investment programs that have no operations or that operate as a blind pool is a projection prohibited by FIRNA Rule 2210(d)(1)(F).

Posted: 9/30/21

D.6.2. Q. If an investment program has both realized and unrealized holdings, may a firm show returns for each of the realized holdings without also showing the program's IRR?
A. Presenting returns solely for realized holdings in a program with ongoing operations without presenting the fund's IRR may be consistent with FINRA Rule 2210 provided that the information presented is fair and balanced. If a communication shows returns for any realized holding, then returns for each realized holding must be shown with equal prominence. "Cherry picking" or excluding returns for realized holdings that performed poorly would be misleading and inconsistent with FINRA Rule 2210(d)(1)(B).

In contrast, unrealized holdings have no actual performance experience, and any return metric would require its valuation to be estimated. Such metrics would represent a prohibited projection under FINRA Rule 2210(d)(1)(F).

Posted: 9/30/21

D.6.3 Q. May a firm aggregate realized holdings of an investment program together into an "aggregate realized investment" return without showing the total program's IRR?
A. As a general matter, it is misleading for a communication to include metrics that combine or average the performance of only the individual realized holdings. Such metrics may mask unequal or poor returns and the results may not be representative of the ultimate performance of the unrealized holdings or the program as a whole. This is the case whether or not the total fund IRR is included.

Posted: 9/30/21

D.6.4 Q. A firm wants to prepare a communication for an ongoing program that includes an IRR and the additional metrics required by the GIPS standards in accordance with *Regulatory Notice 20-21*. Is the firm allowed to also include information beyond what is required by the GIPS standards?
A. Generally, a firm may include information beyond what is required by the GIPS standards in a communication for an ongoing program. Any information must be presented in a fair and balanced manner, must not be misleading, and otherwise must be consistent with the content standards of FINRA Rule 2210(d).

Posted: 9/30/21

D.7. Prohibition on Predictions or Projections of Investment Performance *New*

D.7.1 Q. May a firm include in a retail private placement communication a "target return" to investors if the communication also includes the assumptions and key risks underlying the return?
A. FINRA Rule 2210(d)(1)(F) prohibits predictions or projections of performance, the implication that past performance will recur, and any exaggerated or unwarranted claim, opinion or forecast. As discussed in Regulatory Notice 20-21, "retail communications may not project or predict ***returns to investors*** such as yields, income, dividends, capital appreciation, percentages or any other future investment performance." This prohibition extends to retail communications that include target returns to investors. However, Regulatory Notice 20-21 makes clear that Rule 2210(d)(1)(F) does not prohibit reasonable forecasts of ***issuer operating metrics*** (e.g., forecasted sales, revenues or customer acquisition numbers) that may convey important information regarding the issuer's plans and financial position, provided that the retail communication provides a sound basis for evaluating the facts as required by Rule 2210(d)(1)(A). Such reasonable forecasts may take the form of target issuer operating metrics, so long as the retail communication does not provide a target return to investors. The Notice also provided guidance on the types of information that should be included, and the factors firms should consider, when creating, reviewing, approving or using forecasts of issuer operating metrics in retail communications.

Posted: 12/8/21

E. Limitations on Use of FINRA's Name

(No Q&As currently under this section)

F. Public Appearances

F.1. Supervision *Updated*

F.1.1. Q. If a registered representative makes a scripted presentation at a seminar for prospective retail investors, what is the responsibility of the firm with which the representative is associated to supervise the presentation?

A. A sales script used in a seminar is considered a retail communication under FINRA Rule 2210 (assuming the script is used with more than 25 retail investors within a 30 calendar-day period).

The firm with which the representative is associated is responsible for approving prior to use any retail communication used as part of the seminar presentation. If a retail communication is subject to a filing requirement under FINRA Rule 2210, the firm also must file the communication with FINRA. FINRA Rule 2210(f)(3) requires each firm to establish written procedures that are appropriate to its business, size, structure, and customers to supervise its registered representative's public appearance. These procedures must provide for education and training, documentation of such education and training, and surveillance and follow-up to ensure that representatives implement and adhere to the procedures.

Posted: 1/7/13

F.1.2 Q. Our firm's registered representatives may meet with groups either in person or using online conferencing platforms. How should firms supervise these meetings?

A. Firms must supervise registered representatives' live meetings with customer groups, whether in person or through an online conferencing platform, in a manner reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules, including FINRA Rule 2210(f). This rule provision sets forth supervision and content standards for public appearances such as seminars, forums, media interviews or other public speaking activities that are unscripted and do not constitute retail communications, institutional communications, or correspondence.

Posted: 9/30/21

F.1.3 Q. If a registered representative uses visual aids, such as a whiteboard or dynamic charts, or a chat or instant messaging feature during a live, unscripted online conference, how should a firm supervise these aspects of the presentation?

A. Depending on the nature and number of persons attending the meeting, the use of these visual aids may be correspondence, retail communications or institutional communications, and the firm must supervise them as such. See FINRA Rules 2210(a), 2210(b) and 3110(b)(4). In addition, their content must be consistent with applicable standards, such as those in FINRA Rule 2210(d).

For example, if a representative meets with fewer than 25 retail investors, and uses the chat feature of the online conferencing platform to answer a live question, that chat content meets the definition of correspondence in FINRA Rule 2210(a)(2). The firm must review the chat content in the same manner as required for supervising and reviewing any other correspondence pursuant to FINRA Rule 3110(b) and 3110.06 through .09.

In another example, if during a meeting that includes more than 25 retail investors, a representative uses the chat feature to post an electronic file containing content that promotes a new mutual fund, the content in the file meets the definition of a retail communication in FINRA Rule 2210(a)(5). Because the content in the file promotes a product of the firm, a registered principal must have approved it prior to use as required by FINRA Rule 2210(b)(1)(A). In addition, because the content in the file promotes a specific registered investment company (i.e., the mutual fund), the firm must also submit it to FINRA's Advertising Regulation Department within 10 business days of first use as required by FINRA Rule 2210(c)(3). In contrast, if during an online meeting that includes more than 25 retail investors, a representative responds to a live audience question by using the platform's whiteboarding feature to draw a diagram illustrating the differences between a conventional bond and a stock, that content would meet the definition of a retail communication in FINRA Rule 2210(a)(5). However, because the representative created and posted the whiteboarding content during an online interactive electronic forum, the firm would not have to approve such content prior to use (see FINRA Rule 2210(b)(1)(D)(ii)). Instead, the firm may review the whiteboarding content in the same manner as required for supervising and reviewing correspondence pursuant to FINRA Rule 3110(b) and 3110.06 through .09.

As a final example, a representative of an ETF broker-dealer distributor hosts a webinar attended by 100 registered representatives of other broker dealers. During the presentation, the distributor representative conducts an interactive poll about the latest ETF offered by the distributor. Once the poll is complete, the distributor representative posts the results live to all of the attendees. Because the audience is composed solely of registered representatives, the poll and the results would meet the definition of institutional communication in FINRA Rule 2210(a)(3). As such, the distributor would need to review the poll and the results in accordance with the firm's written supervisory procedures for the supervision of institutional communications adopted in accordance with FINRA Rule 2210(b)(3). While such procedures don't require review of all institutional communications prior to first use, they must include provisions for the education and training of associated persons as to the firm's procedures governing institutional communications, documentation of such education and training, and surveillance and follow-up to ensure that firm personnel implement and adhere to such procedures.

Posted: 9/30/21

F.1.4 Q. If a third party, such as a fund distributor or program sponsor, presents information or speaks with clients during a presentation, either in person or using an online conferencing platform, during which a representative of a broker-dealer also speaks or presents, what must the representative disclose about that third party?

A. FINRA Rule 2210(f)(1) provides that, when participating in unscripted public appearances, associated persons of broker-dealers must follow the standards of FINRA Rule 2210(d)(1). Paragraph (d)(1)(A) requires firms' communications with the public to be fair and balanced, and prohibits the omission of material information that would cause the communication to be misleading. To comply with these obligations, when a registered representative appears at an event along with personnel from a third party, such as a fund distributor or program sponsor, the representative should clearly explain the purpose of the meeting, the identity of the third-party entity, whether the third-party entity paid for or sponsored the meeting, and the relationship between the representative, the broker-dealer, and the third-party entity. [21]

Posted: 9/30/21

F.1.5 Q. If our registered representatives use communications with the public that direct customers to in-person or online presentations hosted by a third party, what supervision requirements apply?
A. A firm is responsible under FINRA Rule 2210 for third-party content if the firm has adopted or become entangled with such content. [22]

If a firm permits its representatives to direct investors to presentations hosted by a third party that concern securities products or services, FINRA would consider the firm to have adopted that content. Accordingly, the firm would need to ensure compliance with the content and supervision standards addressed above.

In addition, even if a firm or its representatives did not direct customers to attend the third-party hosted presentation, where the firm or representative paid for, arranged for, or was otherwise involved in the presentation, FINRA would consider the firm or representative to be entangled with the presentation. Accordingly, FINRA would treat the presentation as a communication with the public by the firm. 23 Again, under such circumstances, the firm would need to ensure compliance with the content, and supervision standards addressed above.

Posted: 9/30/21

F2. Firm Name

F.2.1. Q. Is a registered representative required to disclose the firm's name during a public appearance?
A. The requirement in FINRA Rule 2210(d)(3) to disclose a firm's name applies to retail communications and correspondence. Accordingly, sales scripts, slide presentations and brochures used in connection with a public appearance must disclose the firm's name. A registered representative is not required to disclose the firm's name as part of non-scripted, extemporaneous remarks during a public appearance.

Posted: 1/7/13

G. SEC Advertising Rules

G.1. SEC Rule 482

G.1.1 Q. Does a promotional item, such as a t-shirt, cap or pen, that contains only the name of a mutual fund or fund family, have to include the prospectus offering legend required by SEC Rule 482 under the Securities Act?
A. No. In FINRA's view, promotional items that only contain the name of a mutual fund or fund family would not be considered an "advertisement" for purposes of Rule 482, and therefore, are not subject to the requirements of that rule, including the requirement to include a prospectus offering legend.

Posted: 5/22/15

G.1.2. Q. Is a communication to a customer that lists the customer's securities and other investments held at a firm, or at various broker-dealers, investment advisers and other entities, and the performance of those investments, subject to Rule 482 or Rule 34b-1 under the Investment Company Act of 1940?
A. No. In FINRA's view, assuming the communication merely informs an existing customer of his or her securities holdings and other investment positions held at the firm or at multiple intermediaries, and the prior performance of those investments, and it does not offer securities of a registered investment company, we believe that the communication would not be considered an advertisement for purposes of Rule 482 and Rule 34b-1. However, if the communication explicitly or implicitly induces the purchase of shares of a registered investment company, we believe that the communication could be subject to the requirements of Rule 482 and Rule 34b-1.

Posted: 5/22/15

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1. See FINRA Rule 2241(a)(3), (a)(14), (h)(1), (h)(3), and (h)(5).

2. Unless FINRA specifically directs a firm to file its institutional communications pursuant to FINRA Rule 2210(c)(1)(B), a firm is not required to file its institutional communications with the Advertising Regulation Department. If a firm chooses voluntarily to file a third-party research report that qualifies as an institutional communication, however, an appropriately qualified principal must approve the report prior to filing. See FINRA Rule 2210(b)(1)(F).

3. See also letter from Afshin Atabaki, FINRA, to Wallace W. Kunzman, Jr. (December 1, 2014).

4. See FINRA Rule 2210(c)(7)(F).

5. "Responsive web design" refers to technology that changes the display of a web page in response to the needs of users and the devices they're using. The layout may change based on the size and capabilities of the device. For example, on a phone, users would see content shown in a single column view; a tablet might show the same content in two columns. See "Responsive Web Design Basics."

6. Pursuant to FINRA Rule 2210(c)(7)(B), the firm also would not be required to file future versions of the fund fact sheets (such as fact sheets issued after the end of the next calendar quarter) where the changes are limited to updates of more recent statistical or other non-narrative information and non-predictive narrative information that describes market events during the period covered by the communication or factual changes in portfolio composition or is sourced from a registered investment company's regulatory documents filed with the SEC.

7. For example, FINRA has stated that firms are not required to file information, including performance information, provided to participant-directed individual account plan participants pursuant to DOL Rule 404a-5 under ERISA. See Regulatory Notice 12-02 (January 2012).

8. See *Regulatory Notices 07-59 (FINRA Guidance Regarding Review and Supervision of Electronic Communications) and 10-06 (Guidance on Blogs and Social Networking Web Sites)* for additional guidance on supervision of digital correspondence.

9. FINRA Rule 2210(c)(7)(I) excludes from the filing requirements any reprint or excerpt of any article or report issued by a publisher, provided that (i) the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint that the member is promoting; (ii) neither the member using the reprint nor any underwriter or issuer of a security mentioned in the reprint has commissioned the reprinted article or report; and (iii) the member using the reprint has not materially altered its contents except as necessary to make the reprint consistent with applicable regulatory standards or to correct factual errors.

10. The SEC staff has taken the position, however, that certain interactive content posted on a real-time electronic forum (i.e., chat rooms or other social media) should be filed under the filing requirements of Section 24(b) of the Investment Company Act of 1940 or Rule 497 under the Securities Act of 1933 (Securities Act), even if it is not required to be filed with FINRA under FINRA Rule 2210. See U.S. Securities and Exchange Commission, Division of Investment Management, IM Guidance Update No. 2013-01 (March 2013).

11. See *Notice to Members 06-48* (September 2006).

12. The Hartford Letter defined "Related Performance Information" as "actual performance of all separate or private accounts or funds that have (i) substantially similar investment policies, objectives, and strategies, and (ii) are currently managed or were previously managed by the same adviser or sub-adviser that manages the registered mutual fund that is the subject of an institutional communication."

13. The Hartford Letter defined "Related Accounts" as all separate or private accounts or funds that fall within the definition of "Related Performance Information."

14. FINRA Rule 2210(d)(1)(B) states, "No member may make any false, exaggerated, unwarranted, promissory or misleading statement or claim in any communication. No member may publish, circulate or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading."

15. The June 1997 Issue of NASD's *Regulatory and Compliance Alert* included an "Ask the Analyst" question and answer regarding banner advertisements. The answer indicated that a banner advertisement that contained a truthful claim regarding mutual funds (and that did not contain promissory language or graphics) could comply with the Rules by hyperlinking to a webpage containing the information necessary to provide a sound basis to evaluate the facts regarding the mutual funds. FINRA has extended this approach to other electronic communications such as interactive social media posts.

16. See *Regulatory Notice 17-18 (Guidance on Social Networking Websites and Business Communications)*.

17. See Investment Advisers Act Rule 206(4)-1(a)(4); see also Investment Advisers Act Release No. 5653 (December 22, 2020), 86 FR 13024 (March 5, 2021) ("Marketing Rule Adopting Release"), codified at 17 CFR 275.206(4)-1.

18. In particular, the Marketing Rule Adopting Release states that, "[s]o long as each layer of a layered advertisement complies with the requirement to provide benefits and risks in a fair and balanced manner, providing hyperlinks to additional content would meet the requirement of [the Rule]." See Marketing Rule Adopting Release, 86 FR at 13044 and note 239.

19. For details, see *Global Investment Performance Standards (GIPS) For Firms* (2020), *GIPS Standards Handbook for Firms* (2020) and *FINRA Regulatory Notice 20-21 and the GIPS Standards* (video).

20. For specific details on the requirements of this limited exception, see Memorandum RE: FINRA's Regulatory Notice 20-21 and References to the GIPS Standards.

21. See *Regulatory Notice 07-43 (Senior Investors)* and *Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars* for a discussion of effective practices regarding sales seminars.

22. See, e.g., ***Regulatory Notice 17-18*** *(Guidance on Social Networking Websites and Business Communications)*.

23. See ***Regulatory Notice 10-06*** *(Guidance on Blogs and Social Networking Web Sites)* for a discussion of the "adoption" and "entanglement" theories as they apply to third-party content.

Frequently Asked Questions Related to Regulatory Relief Due to the Coronavirus Pandemic

Due to the coronavirus pandemic (COVID-19), FINRA is providing temporary relief for member firms from rules and requirements in the Frequently Asked Questions below. The relief provided does not extend beyond the identified rules and requirements. FINRA will continue to monitor the situation to determine whether additional guidance and relief may be appropriate. As coronavirus-related risks decrease, member firms should expect to return to meeting any regulatory obligations for which relief has been provided. When appropriate, FINRA will publish a Regulatory Notice announcing a termination date for the regulatory relief that will provide member firms with time to make necessary operational adjustments.

FINRA has issued a new FAQ that addresses a question regarding the hosting of virtual business entertainment events or meetings that has been asked frequently during the COVID-19 pandemic.

Advertising Regulation

Q. Our firm's registered representatives are unable to meet with their customers face-to-face because they are working from home or due to COVID-19 related restrictions, and instead are meeting with clients via a live video or audio conferencing platform. How should our firm supervise these meetings? Is the firm required to keep records of these live video meetings?

A: Members must supervise registered representatives' live meetings with customers via video or audio conferencing platforms in a manner reasonably designed to achieve compliance with applicable securities laws and regulation and FINRA rules.

Unless required to record pursuant to FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms) or otherwise, members generally are not required to record live video or audio conferences with customers. However, if a registered representative during the video or audio conference uses the chat or instant messaging feature of the platform or presents slides or other written (including electronic) communications, the member must keep records of these written communications in accordance with Securities Exchange Act Rule 17a-4 and FINRA Rules 3110.09 (Supervision) and 4511 (General Requirements), and their content must be consistent with applicable standards such as FINRA Rule 2210 (Communications with the Public) and 3110(b) (Supervision). Depending on the nature and number of persons attending the video meeting, these written communications may be correspondence, retail communications or institutional communications, and must be supervised as such. See FINRA Rules 2210(b) and 3110(b)(4).

Moreover, if a member chooses to record live video or audio conversations with customers, the member may be required to produce the recording in connection with a regulatory request. If a firm permits public appearances through video or audio conferencing platforms, the member must ensure compliance with FINRA Rule 2210(f).

Added April 16, 2020

Q: What steps should members consider regarding communicating with customers?

A: As discussed in Regulatory Notice 20-08, FINRA understands that members may experience significantly increased customer call volumes or online account usage during a pandemic (e.g., due to significant market movements), which may cause temporary operational challenges. Members are encouraged to review their BCPs regarding communicating with customers and ensuring customer access to funds and securities during a significant business disruption.

If registered representatives are unavailable to service their customers, members are encouraged to promptly place a notice on their websites indicating to affected customers who they may contact concerning the execution of trades, their accounts, and access to funds or securities. Supervisory control policies and procedures should be considered that will mitigate risks that may arise due to the reduced ability to communicate with customers, inability to rely on mail or other disruption to the existing controls over communications with customers.

Added March 24, 2020

Q: Is my firm required to file non-promotional communications with FINRA?

A: No. FINRA Rule 2210(c)(7) (Communications with the Public) excludes from Rule 2210's filing requirement retail communications that do not make any financial or investment recommendation or otherwise promote a product or service of the member. For example, a member is not required to file with FINRA a retail communication regarding COVID-19 that does not make any financial or investment recommendation or promote a product or service of the member.

Additional information on exclusions from Rule 2210's filing requirement are included in FINRA Advertising Regulation Department's dedicated FAQs. Members with additional questions may also contact the FINRA Advertising Regulation Department ((240) 386-4500 or finra_adv@finra.org).

Added March 24, 2020

Regulatory Notice 20-14

Oil-Linked Exchange-Traded Products

Sales Practice Obligations With Respect to Oil-Linked Exchange-Traded Products

May 15, 2020

Notice Type

- Guidance

Suggested Routing

- Legal and Compliance
- Registered Representatives
- Retail
- Senior Management

Key Topics

- Communications with the Public
- Oil-Linked Exchange-Traded Products
- Suitability
- Supervision
- Training

Referenced Rules & Notices

- FINRA Rule 2111
- FINRA Rule 2210
- FINRA Rule 3110
- Notice to Members 05-26
- Regulatory Notice 09-31
- Regulatory Notice 10-51
- Regulatory Notice 12-03
- Regulatory Notice 17-32
- SEC Regulation Best Interest

Summary

Exchange-traded products (ETPs) provide different types of exposure to the oil market through several product structures, which some investors or investment professionals might not understand.[1] Moreover, the performance of such products may be linked to unfamiliar indices or reference benchmarks, making them difficult for the average investor to comprehend. In particular, a number of these ETPs are designed to track daily price movements of specified crude oil futures contracts, such as those on West Texas Intermediate (WTI) light, sweet crude oil (referred to herein as "oil-linked ETPs").[2] Due to recent extraordinary conditions in crude oil markets, combined with the manner in which the products are structured, several oil-linked ETPs have experienced significant volatility and lost a substantial percentage of their value, with at least one ETP liquidating and another forced to halt the issuance of new shares and adjust its investment objective.

These concerns are not limited to oil-linked ETPs: some other commodity-linked products, such as natural gas ETPs, as well as volatility-linked ETPs, may share similar features and have been the subject of prior FINRA guidance and regulatory action.[3] Based on FINRA's experience with complex products broadly, some investors—as well as investment professionals recommending them—may not understand oil-linked ETPs' investment objectives, how their performance relates to the "spot" (or cash) price of oil, or how the different product structures can impact their performance and the investor experience.[4]

This *Notice* reminds firms of their sales practice obligations in connection with oil-linked ETPs, including that recommendations to customers must be based on a full understanding of the terms, features, and risks of the product recommended; communications with the public must be fair and accurate; firms must have reasonably designed supervisory procedures in place to ensure that these obligations are met; and firms that offer oil-linked ETPs must train registered representatives who sell these products about the terms, features and risks of these products.

Questions concerning this *Notice* should be directed to:

- Joseph P. Savage, Vice President, Office of General Counsel, at (240) 386-4534 or by email at *joe.savage@finra.org*;
- Amy Sochard, Vice President, Advertising Regulation, at (240) 386-4508 or by email at *amy.sochard@finra.org*; or
- Richard Vagnoni, Senior Economist, Office of Financial Innovation, at (202) 728-6934 or by email at *richard.vagnoni@finra.org*.

Background and Discussion

Given the practical difficulties of investing directly in commodities such as oil, commodity-linked ETPs often track commodity futures or futures indices rather than the underlying spot commodity. As with other commodity-linked ETPs, such as those linked to natural gas, oil-linked ETPs generally provide exposure to the price of oil by tracking oil futures through two different ETP structures—ETNs and commodity pools.

Oil-linked ETNs, which are debt obligations of an issuer and do not hold any underlying portfolio, promise to pay the note holder a return linked to the performance of an index at note maturity. ETN issuers have significant discretion in the creation (*i.e.,* issuance) of new notes as well as note redemption (*e.g.,* early termination), which can impact the performance that a note holder experiences and the extent to which the market price of the note reflects its value.[5]

In contrast to ETNs, commodity pools do hold an underlying portfolio of futures (or other commodity interests). While similar to ETFs, a commodity pool ETP has unique structural features that can introduce additional risks. For example, a commodity pool ETP must update its registration statement with the SEC once every three years and must file a new registration statement for new shares if the existing share limit under the effective registration statement is reached. An ETP structured as a commodity pool also may be subject to position limits in terms of the number of futures contracts that it may hold or issues related to margin. These features can limit the ETP's ability to create shares, which can result in a tendency for the ETP's market price to deviate from the underlying value of the ETP, or cause the ETP to change investment holdings (*e.g.,* using different futures contracts or swaps).

As lockdowns related to the coronavirus disease (COVID-19) remain in force, oil demand has declined precipitously and excess storage capacity has reportedly decreased significantly as well, pushing crude oil prices to record lows. Recently the June 2020 WTI crude oil futures contract fell 43 percent to close at $11.57 per barrel—only one day after the expiring May 2020 WTI contract price dropped below zero and settled at *minus* $37.63 per barrel.[6] This plunge in market value has significantly impacted ETPs tracking WTI futures.

For example, as of April 22, 2020, the largest oil-related ETP had lost 41 percent of its value in one week. This ETP also subsequently adjusted its investment focus from near-dated futures to longer-dated contracts.[7] Reports suggest that retail investors have been investing in oil-linked ETPs during this volatile period. Surging investor demand for this oil-linked ETP in particular led to a dramatic increase in new share issuance, which ultimately exhausted the number of available shares permitted to be issued under the ETP's existing registration statement.

As a result, this ETP was unable to issue new shares until a new registration statement was filed with the SEC and became effective. With its normal share creation mechanism non-operational, there have been significant variations between the market price at which shares are traded and the shares' net asset value.

Separately, the issuer of another oil-related ETN tracking WTI futures announced an early liquidation.[8] Leveraged and inverse oil-linked ETPs that seek to deliver multiples or the opposite of the return of an oil-linked index likewise have been extremely volatile during these market conditions.

Experience with similar complex products suggests that some retail investors and investment professionals recommending oil-linked ETPs, including commodity pools and ETNs, may have mistakenly thought that these ETPs are a proxy for the spot price of oil, when in fact their investment objectives are to track oil futures contracts.[9] Rather than tracking the spot price, oil-linked ETPs generally provide exposure to oil by tracking short-term or other oil futures or futures indices. These ETPs may track or hold futures contracts on a rolling basis, meaning that they will replace shorter-term contracts or contracts about to expire with contracts that have more distant or deferred expiration dates in order to maintain the desired exposure.

An ETP whose objective is to provide exposure to the near-month futures contract may roll out of the near-month contract as it approaches expiration and into the next-month contract over a series of days. If the prices of futures contracts with more distant expiration dates are higher than those with shorter dates, the market is often said to be in "contango." Other things being equal, rolling out of shorter-term contracts into longer-term contracts in such a market can lead to losses. If the opposite is true, the market is often said to be in "backwardation," and rolling out of shorter-term contracts into longer-term contracts can lead to gains.

The oil futures market has experienced both periods of backwardation and contango over the last decade. Over longer time horizons, these features of the futures market can be a factor that leads to a divergence in the performance of a futures-linked ETP and that of the spot commodity, and in some cases that divergence can be significant. Recently, the oil futures market has been in "super-contango," as oil storage capacity has diminished, which can exacerbate losses to investors who hold oil-linked ETPs for extended periods of time.

Sales Practice Obligations

Over the years, FINRA has published guidance to firms about the risks of recommending complex products, such as oil-linked ETPs, to retail customers, particularly buy-and-hold retail investors with an intermediate- or long-term time horizon. *Regulatory Notice 10-51* reminded firms of their sales practice obligations with regard to commodity futures-linked securities.[10] That *Notice* discussed the volatility of oil prices and the risk that commodity futures-linked securities can perform differently than the spot price for the commodity itself, which can lead to unexpected results for investors who do not understand the product or who mistakenly believe the product will replicate the performance of the commodity's spot price. *Regulatory Notice 12-03* addressed similar issues in the context of complex products generally.[11]

As detailed in *Regulatory Notice 12-03*, investments tied to the performance of securities, indices, commodities or markets that may not be well known or well understood by investors, such as oil-linked ETPs, are "complex" products. Firms should review *Regulatory Notice 12-03* and consider whether to use the type of heightened scrutiny and supervision suggested therein for these complex products.[12] Firms are similarly reminded that they must comply with the obligations discussed below when offering oil-linked ETPs.

Suitability and Regulation Best Interest

FINRA Rule 2111 (Suitability) requires a firm or associated person making a recommendation to have a reasonable basis to believe that the recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. Two of the main suitability obligations delineated in Rule 2111 that are particularly relevant to oil-linked ETPs are customer-specific and reasonable-basis suitability.

Customer-specific suitability requires a firm or its associated persons to have a reasonable basis to believe that a recommendation is suitable for a particular customer based on the customer's investment profile, including the customer's investment experience, risk tolerance, liquidity needs, investment objectives, and financial situation and needs.[13] For example, depending on the facts and circumstances, an oil-linked ETP might be suitable for an experienced customer with a speculative investment objective, but it likely would not be suitable for a less experienced customer or a customer with a more conservative or a buy-and-hold investment objective.

Reasonable-basis suitability requires that the firm or associated person recommending a securities transaction or investment strategy involving securities perform reasonable diligence to understand the nature of that transaction or strategy, as well as potential risks, and then determine whether there is a reasonable basis to believe, based on the reasonable diligence, that the recommendation is suitable for at least some investors. The level of reasonable diligence that is required will rise with the complexity and risks associated with the transaction or strategy.

With regard to a complex product such as an oil-linked ETP, an associated person should be capable of explaining, at a minimum, the product's main features and associated risks.[14] These would include, for example, understanding generally how products tracking futures contracts or futures indices work, how contango and backwardation may affect their performance, and how such products may perform relative to the spot asset (*e.g.,* oil), especially over extended periods of time.

Oil-linked ETPs may employ various strategies (*e.g.,* focusing on short-term futures versus more diversified exposure), so understanding the differences among the various offerings is important as well. Some products are designed to be used more tactically—on a shorter-term basis—such as geared (*i.e.,* leveraged or inverse) ETPs, and such products would be particularly unsuitable for customers intending to buy and hold securities. An associated person should understand the differences in product structures (*e.g.,* commodity pool versus ETN) and how the structural features of different ETPs may present additional risks (*e.g.,* suspension of new issuance or accelerated termination).

Starting on June 30, 2020, recommendations of securities, including oil-linked ETPs, to retail customers will be governed by SEC Regulation Best Interest ("Reg BI").[15] Reg BI enhances firms' standard of conduct beyond existing suitability obligations by, among other things, requiring firms to act in the retail customer's best interest at the time the recommendation is made, without placing the financial or other interests of the firm ahead of the interests of the retail customer.[16] Firms should ensure that any recommendations of oil-linked ETPs made after the compliance date comply with their Reg BI obligations.

Communications with the Public

FINRA Rule 2210 (Communications with the Public) requires, among other things, that all communications with the public be based on principles of fair dealing and good faith, be fair and balanced, and provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service. Communications regarding oil-linked ETPs that present the benefits of the products must be balanced by a clear description of the risks, and may not omit any material fact or qualification that would cause such a communication to be misleading. For example, communications that present the benefits of oil-linked ETPs must include key risks such as the inherent fluctuations of oil prices and the speculative nature of futures investments, and must explain clearly that the ETP's price will not track directly the spot price of oil.

Communications that present the benefits of oil-linked ETPs or other investments that rely on futures must explain how the investment may be impacted by contango and backwardation. Further, communications concerning an ETP that is designed to achieve its investment objective on a short-term basis (*e.g.,* daily) must state that fact and specifically disclose that the ETP is not designed to, and will not necessarily, track the underlying index or benchmark over a longer period of time. FINRA reminds firms that providing risk disclosure in a separate document such as a prospectus does not cure otherwise deficient disclosure in sales material, even if the sales material is accompanied or preceded by the prospectus.

Supervision

FINRA Rule 3110 (Supervision) requires that firms establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. A reasonably designed system must be tailored specifically to a member's business, taking into account among other things, the nature and complexity of the products offered and the customer base.

Oil-linked ETPs are complex products that could be easily misunderstood and improperly sold by registered representatives. As discussed in *Regulatory Notice 12-03* and noted above, firms should consider whether to use heightened scrutiny and supervision of these ETPs. Firms must act reasonably to ensure that their registered representatives and supervisors understand the risks presented by such products.

Training

Firms that offer oil-linked ETPs must train registered persons about the terms, features and risks of these products, as well as the factors that would make such products either suitable or unsuitable for certain investors, particularly retail investors.[17] Training should emphasize the need to understand and consider the risks associated with such products, including the investor's time horizon, and the impact of time and volatility on the ETP's performance. Training should emphasize that, due to the complexity and structure of these products, they may not perform over time in direct correlation to their underlying index or benchmark. Additionally, when recommending complex products such as oil-linked ETPs, firms and associated persons should consider whether less complex or less costly products could achieve the same objective for their customers.

Conclusion

Oil-linked ETPs are complex products that may not be suitable for some investors, such as retail investors with conservative investment objectives and long time horizons. Given the heightened risks that these products raise, firms must be diligent in ensuring that their sales of these products are consistent with the requirements under the suitability, communications and supervision rules, and beginning on June 30, 2020, their obligations under Reg BI, as well as other applicable rules and requirements. Firms are reminded of their obligation to put reasonably designed supervisory controls in place, and to train their registered representatives and supervisors to ensure that suitability and other obligations under FINRA and SEC rules are met.

Endnotes

1. An ETP is a security listed on an exchange that seeks to provide exposure to the performance of an index, benchmark, or actively-managed strategy. The most common type of ETP is the exchange- traded fund (ETF). ETFs are registered under the Investment Company Act of 1940 (1940 Act), and are organized under the laws used for the issuance and governance of mutual funds. Other ETPs, which are not registered under the 1940 Act, include commodity pools, which invest in futures, grantor trusts, which hold physical commodities or currencies, and exchange-traded notes (ETNs), which track an index or benchmark but are debt obligations of an issuer and hold no underlying portfolio. While ETPs are often referred to as exchange-traded "funds" or "ETFs," there are important differences among the various legal or tax-related structures that are used across the product range—and such differences have implications for investors and product issuers. All ETPs are registered under the Securities Act of 1933 and Securities Exchange Act of 1934, but different ETPs may be subject to different regulatory requirements and oversight by different Securities and Exchange Commission (SEC) divisions or the Commodity Futures Trading Commission depending on their particular structures. Moreover, there is no universally-accepted comprehensive naming framework for the products. Differences among the various ETP structures include the asset classes in which portfolios may invest, how portfolios are constructed, use of derivatives and securities lending, when and if distributions are reinvested, and how taxes are assessed.

2. For the purposes of this *Notice*, "oil-linked ETPs" include ETPs that seek to provide exposure to oil as an asset as represented by investments in exchange-traded crude oil futures contracts and ETNs that are designed to provide exposure to an oil-linked futures price index.

3. *See, e.g., Regulatory Notice 10-51* (October 2010) (Sales Practice Obligations for Commodity Futures-Linked Securities) and *Regulatory Notice 17-32* (October 2017) (FINRA Reminds Firms of Sales Practice Obligations for Volatility-Linked Exchange-Traded Products).

4. *See* Cadaret, Grant & Co., Inc., Securities Act Release No. 10542, 2018 SEC LEXIS 2239 (Sept. 11, 2018).

5. For a discussion of the risks of investing in ETNs, including the risk of early termination, *see* FINRA Investor Alert, "Exchange-Traded Notes – Avoid Unpleasant Surprises" (July 10, 2012).

6. *See* "Collapse in Oil Prices Deepens, Dragging Down Markets Globally," *The Wall Street Journal*, April 22, 2020, p. A1.

7. *See* "Oil Wagers Burn Some Individual Investors," The Wall Street Journal, April 22, 2020, p. B1.

8. *See* "Oil Wagers Burn Some Individual Investors," *The Wall Street Journal*, April 22, 2020, p. B13; *see also* Barclays press release, "Barclays announces the redemption of the iPath® Series B S&P GSCI® Crude Oil Total Return Index ETNs (the "ETNs") and the suspension of further sales and issuance of the ETNs," (April 20, 2020).

9. *See* Kate Rooney, "Young investors rush into struggling oil ETF that isn't even tracking the price of oil anymore" (April 23, 2020), available at www.cnbc.com.

10. *See* *Regulatory Notice 10-51* (October 2010) (Sales Practice Obligations for Commodity Futures-Linked Securities). Notice 10-51 addressed firms' obligations with regard to suitability, communications with the public, supervision and training.

11. *See* *Regulatory Notice 12-03* (January 2012) (Heightened Supervision of Complex Products).

12. *See id*.

13. A customer's investment profile also includes the customer's age, other investments, tax status, investment time horizon, and any other information the customer may disclose to the member or associated person in connection with such recommendation. *See* FINRA Rule 2111(a).

14. FINRA notes, as well, the importance of vetting of new products, particularly new products that are complex or have potentially high levels of risk associated with them. *See, e.g., Regulatory Notice 05-26* (April 2005) (NASD Recommends Best Practices for Reviewing New Products) (highlighting best practices for vetting new products), and *Regulatory Notice 09-31* (June 2009) (FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds) (concerning the obligation to vet new complex and non-traditional ETFs).

15. 17 CFR 240.15l-1; *see also* Securities Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318 (July 12, 2019).

16. Under Reg BI, a "retail customer" is a natural person or the legal representative of the natural person, who (i) receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer, and (ii) uses the recommendation primarily for personal, family, or household purposes. 17 CFR 240.15l-1(b)(1). A retail customer may include a natural person who falls within the definition of "institutional account" under FINRA Rule 4512(c) (*e.g.,* a natural person with total assets of at least $50 million), and thus previously was excluded from the customer-specific suitability requirements of FINRA Rule 2111 under specified conditions.

17. *See* *Notice to Members 05-26* (April 2005) (NASD Recommends Best Practices for Reviewing New Products).

Regulatory Notice 20-21

Communications With the Public

FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings

Summary

This *Notice* provides guidance to help member firms comply with FINRA Rule 2210, Communications with the Public, when creating, reviewing, approving, distributing, or using retail communications concerning private placement offerings.

Questions concerning this *Notice* should be directed to:

- Amy C. Sochard, Vice President, Advertising Regulation, at (240) 386-4508; or
- Ira D. Gluck, Director, Advertising Regulation, at (240) 386-4614.

Background and Discussion

Private Placement Offerings

Private placements are unregistered, non-public securities offerings that rely on an available exemption from registration with the Securities and Exchange Commission (SEC) under either Sections 3 or 4 of the Securities Act of 1933 (Securities Act).[1] Most private offerings, however, are sold pursuant to one of three "safe harbors" under Rules 504, 506(b), and 506(c) of Securities Act Regulation D (Reg D).[2]

Reg D requires companies and funds to file a Form D through the SEC's EDGAR system when selling unregistered securities based on a claimed Reg D exemption. The most recent Reg D data published by the SEC's Division of Economic and Risk Analysis indicates that issuers make approximately 20,000 new offering Reg D filings with the SEC each year.[3] Of this total, approximately 4,000 new offerings identify an "intermediary," such as a broker or finder, as participating in an offering.

Private placements sold by FINRA member firms to individuals generally must be filed with FINRA. In this regard, FINRA Rules 5122 and 5123 require a member firm to file offering documents regarding specified private placements in which the member firm participates.[4] FINRA receives

July 1, 2020

Notice Type
- Guidance

Suggested Routing
- Advertising
- Compliance
- Corporate Financing
- Legal
- Operations
- Registered Representatives
- Senior Management

Key Topics
- Communications with the Public
- Private Placements
- Retail Communications

Referenced Rules
- FINRA Rule 2210
- Regulation D
- Regulatory Notice 10-22
- Regulatory Notice 13-18
- Regulatory Notice 19-31

FINRA

approximately 2,000 new offering filings from its member firms each year,[5] and uses analytics and trained analysts to conduct a risk-based review of each filing. The number of annual filings with FINRA indicates that approximately half of the Reg D filings identifying intermediaries are for offerings by entities that are not subject to FINRA rules or offerings by member firms that are not required to file under Rules 5122 or 5123.

The offerings that are sold directly by issuers or through the efforts of intermediaries that are not FINRA member firms are not subject to the regulatory requirements applicable under FINRA rules and are not subject to FINRA's examination and review programs. Although FINRA does not have jurisdiction over Reg D private placements that are sold directly to investors or through non-member firm intermediaries, it is committed to promoting investor protection through meaningful regulation and oversight of member firms participating in these offerings.

The remainder of this *Notice* addresses the subset of private placements conducted by member firms.

Private Placement Retail Communications

Many private placement offerings to retail investors include marketing or sales communications that meet the definition of retail communication in Rule 2210(a)(5).[6] For example, FINRA has observed that more than 40 percent of the offerings filed pursuant to FINRA Rule 5123 include retail communications. In addition, the adoption of Rule 506(c) under Reg D eliminated the prohibition against general solicitation and advertising for private placement offerings where all purchasers of the securities are verified accredited investors. Consequently, member firms have become increasingly involved in the distribution of private placement securities through online platforms and other widely disseminated communications such as digital advertisements.[7]

FINRA Rule 2210(d)(1) requires that all member firm communications be fair, balanced and not misleading. Communications that promote the potential rewards of an investment also must disclose the associated risks in a balanced manner.[8] In addition, communications must be accurate and provide a sound basis to evaluate the facts with respect to the products or services discussed. Rule 2210(d)(1) also prohibits false, misleading or promissory statements or claims, and prohibits the publication, circulation or distribution of a communication that a member firm knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading. With few exceptions, Rule 2210(b)(1) requires that an appropriately registered principal approve each retail communication before the earlier of its use or filing with FINRA's Advertising Regulation Department.[9]

Recent FINRA reviews of retail communications concerning private placements have revealed deficiencies. For instance, most if not all investments in private placements are illiquid, and many such investments are speculative in nature. Some retail communications do not balance claims of these investments' benefits by disclosing these risks. Others have contained false, misleading, or promissory statements or claims such as assertions about the likelihood of a future public offering of the issuer, claims about the future success of the issuer's new or untried business model, inaccurate or misleading assertions concerning the regulation or relative risk of the offering, or predictions or projections of investment performance prohibited by FINRA Rule 2210(d)(1)(F).

FINRA is providing the following guidance to assist member firms in their creation, review, approval, distribution or use of retail communications concerning private placement securities.

Third-Party Prepared Materials

Rule 2210(a)(5) defines "retail communication" as "any written (including electronic) communication that is ***distributed or made available*** to more than 25 retail investors within any 30 calendar-day period."[10] FINRA disciplinary actions demonstrate that member firms can be liable for violations of Rule 2210 when distributing or using noncompliant retail communications prepared by a third party.[11]

Regulatory Notice 10-22 states that "[a member firm] that assists in the preparation of a private placement memorandum or other offering document should expect that it will be considered a communication with the public by that [member firm] for purposes of … Rule 2210, FINRA's advertising rule. If a private placement memorandum or other offering document presents information that is not fair and balanced or that is misleading, then the [member firm] that assisted in its preparation may be deemed to have violated … Rule 2210." *Notice 10-22* also provides that "sales literature concerning a private placement that a [member firm] distributes will generally be deemed to constitute a communication by that [member firm] with the public, whether or not the [member firm] assisted in its preparation."

In addition, FINRA has observed that some issuer-prepared private placement memoranda (PPMs) are bound or presented as one electronic file with retail communications, such as cover pages or exhibits. Such retail communications are distinguishable by their marketing or promotional content from the factual descriptions and financial information about the issuer generally disclosed in the PPMs. Regardless of whether a member firm distributes a retail communication that is attached to a PPM or as a standalone document, it constitutes a communication of the member firm subject to Rule 2210.

Balanced Presentation of Risks and Investment Benefits

Rule 2210 requires communications that discuss the benefits of an investment also to include a discussion of its risks.[12] As indicated above, retail communications that discuss the potential benefits of investing in private placements should balance this discussion with disclosure of their risks, such as the potential for private placement investments to lose value, their lack of liquidity and their speculative nature. Providing risk disclosure in a separate document, such as a PPM, or in a different section of a website does not substitute for disclosure contained in or integrated with retail communications governed by Rule 2210.

Retail communications often highlight the business of the issuer and discuss the value proposition of a potential investment. In such cases, the key risks associated with an investment in the issuer are necessary in order to balance the positive portrayal of the investment. For example, when the issuer is a startup company, the risks may include a limited track record; more experienced or larger competitors; overreliance on financing; reliance on a single supplier, customer or employee; or lack of management experience.

Reasonable Forecasts of Issuer Operating Metrics

Rule 2210(d)(1)(F) generally prohibits the use of any prediction or projection of performance, as well as any exaggerated or unwarranted claim, opinion or forecast.[13] Accordingly, retail communications concerning private placements may not project or predict ***returns to investors*** such as yields, income, dividends, capital appreciation percentages or any other future investment performance.

However, FINRA would not consider reasonable forecasts of ***issuer operating metrics*** (*e.g.*, forecasted sales, revenues or customer acquisition numbers) that may convey important information regarding the issuer's plans and financial position to be inconsistent with the rule. Presentations of reasonable forecasts of issuer operating metrics should provide a sound basis for evaluating the facts as required by Rule 2210(d)(1)(A). For example, such presentations should include clear explanations of the key assumptions underlying the forecasted issuer operating metrics and the key risks that may impede the issuer's achievement of the forecasted metrics.

When creating, reviewing, approving, distributing or using forecasts of issuer operating metrics in retail communications, member firms should consider:

I. the time period forecasted (generally a time period in excess of five years would be unreasonable);

II. whether growth rate assumptions are commensurate with the nature and scale of the business;

III. whether forecasted gross margins[14] are commensurate with industry averages; and

IV. whether sales and customer acquisition forecasts are reasonable in relation to the overall market for the issuer's products or services.

While sources of contractual revenue such as royalty or master lease agreements may inform or provide a basis for reasonable forecasts of issuer operating metrics, it would be inconsistent with Rule 2210(d)(1)(B) to characterize specific revenue or cash flow as guaranteed or certain. Moreover, Rule 2210(d)(1)(F) precludes member firms from using the data from forecasts of issuer operating metrics to project or depict specific investment returns to an investor.

Distribution Rates

Regulatory Notice 13-18 provided guidance to member firms regarding communications with the public for registered and unregistered real estate investment programs. Given that some non-real estate private placement investments employ similar structures, the principles relating to distribution rates contained in that *Notice* are applicable to retail communications regarding private placement investments designed to provide distributions to investors and are reiterated below.

Some issuers fund a portion of their distributions through return of principal or loan proceeds. For example, a portion of a newer program's distributions might include a return of principal until its assets are generating significant cash flows from operations. Consistent with Rule 2210(d)(1)(B)'s prohibition of false, exaggerated, unwarranted, promissory or misleading claim, member firms must not misrepresent the amount or composition of such distributions. Nor may member firms state or imply that a distribution rate is a "yield" or "current yield" or that investment in the program is comparable to a fixed income investment such as a bond or note. Presentations of distribution rates consistent with Rule 2210 would disclose:

- that distribution payments are not guaranteed and may be modified at the program's discretion;
- if the distribution rate consists of return of principal (including offering proceeds) or borrowings, a breakdown of the components of the distribution rate showing what portion of the quoted percentage represents cash flows from the program's investments or operations, what portion represents return of principal, and what portion represents borrowings;
- the time period during which the distributions have been funded from return of principal (including offering proceeds), borrowings or any sources other than cash flows from investment or operations;
- if the distributions include a return of principal, that by returning principal to investors, the program will have less money to invest, which may lower its overall return; and
- if the distributions include borrowed funds, that since borrowed funds were used to pay distributions, the distribution rate may not be sustainable.[15]

FINRA believes that it is inconsistent with Rule 2210(d)(1) for retail communications to include an annualized distribution rate until the program has paid distributions that are, on an annualized basis, at a minimum equal to that rate for at least two consecutive full quarterly periods.[16]

Internal Rate of Return

Internal Rate of Return (IRR) is a measure of performance commonly used in connection with marketing private placements of real estate, private equity and venture capital. IRR shows a return earned by investors over a particular period, calculated on the basis of cash flows to and from investors (*i.e.,* the percentage rate earned on each dollar invested for each period the dollar was invested). IRR is calculated as the discount rate that makes the net present value of all cash flows from an investment equal to zero.[17]

A drawback of IRR calculations is their inherent assumption that investors will be able to reinvest any distributions from the investment at the IRR rate. In practice, it is unlikely that this would occur. Another drawback is that in order to calculate IRR for a portfolio that includes holdings that have not yet been sold (or otherwise liquidated or matured), a valuation of those remaining assets must be estimated. Depending on the nature of the asset, these estimated values may be based on subjective factors and assumptions.

The use of IRR in retail communications concerning privately placed new investment programs that have no operations or that operate as a blind pool would be inconsistent with the prohibition on unwarranted forecasts or projections in Rule 2210(d)(1)(F).

Nevertheless, FINRA interprets Rule 2210 to permit retail communications to include IRR for completed investment programs (*e.g.,* the holding matured or all holdings in the pool have been sold). In addition, FINRA does not view as inconsistent with the rule retail communications that provide an IRR for a specific investment in a portfolio if the IRR represents the actual performance of that holding.

Investment programs such as private equity funds and REITs may have a combination of realized investments and unrealized holdings in their portfolios. Where the program has ongoing operations, FINRA interprets Rule 2210 to permit the inclusion of IRR if it is calculated in a manner consistent with the Global Investment Performance Standards (GIPS) adopted by the CFA Institute and includes additional GIPS-required metrics such as paid-in capital, committed capital and distributions paid to investors.[18]

Endnotes

1. *See* 15 U.S.C. 77c and 77d.
2. *See* 17 CFR 230.504, 230.506(b) and 230.506(c).
3. *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017:* *https://www.sec.gov/dera/staff-papers/white-papers/dera_white_paper_regulation_d_082018*.
4. Rules 5122 and 5123 provide exemptions from the filing requirement when certain types of securities are sold or securities are sold to certain types of investors. For example, member firms are not required to file offerings made pursuant to Securities Act Rule 144A or Regulation S, or offerings sold solely to institutional accounts as defined in FINRA Rule 4512(c). *See* Rules 5122(c) and 5123(b). As a result of these exemptions, both rules apply predominately to retail private placements.
5. The total for "new offering filings" excludes duplicate filings for the same offering by different member firms.
6. "Retail communication" means any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period.
7. *See* FINRA's 2019 Annual Risk Monitoring and Examinations Priorities Letter (January 2019). The letter discusses factors FINRA may consider in reviewing online distribution platforms.
8. *See* *Regulatory Notice 19-31* (September 19, 2019), Question 3 ("FINRA rules require that communications be fair and balanced, but don't require them to be exhaustive lists of all possible risks and warnings associated with a product or service. Information about risks, costs or drawbacks is more effective when it is related to the benefits that the communication promotes.").
9. For example, pursuant to Rule 2210(b)(1)(C), if a member firm has already filed a retail communication with FINRA's Advertising Regulation Department and received a letter indicating that such communication appears to be consistent with applicable standards, another member firm may use that communication without having a principal approve it, provided the communication is not materially altered or used in a manner that is inconsistent with the department's letter.
10. Emphasis added. Rule 2210's definitions of correspondence and institutional communications also refer to communications that are "distributed or made available" to particular investors. *See* FINRA Rules 2210(a)(2) and (a)(3).
11. *See e.g., Phillipe N. Keyes*, 89 S.E.C. 792, 800 (2006), *Sheen Financial Resources, Inc.,* Exchange Act Release No. 35477, 52 SEC 185, SEC LEXIS 613 (1995), Fidelity Brokerage Services LLC, Letter of Acceptance, Waiver and Consent No. 2008013056101 (2011) or HSBC Securities (USA) Inc., Letter of Acceptance Waiver and Consent No 008013863801 (2010).
12. *See* FINRA Rule 2210(d)(1)(D).
13. Rule 2210(d)(1)(F) contains three exceptions from this prohibition, subject to specified conditions: (1) hypothetical illustrations of mathematical principles; (2) investment analysis tools and reports generated by such tools; and (3) a price target contained in a research report.
14. Gross margin represents the percent of total sales revenue that the company retains after incurring the direct costs associated with producing the goods and services sold by a company. *See Jay Michael Fertman*, 51 SEC 943,950 (1994) and *Excel Fin., Inc.,* 53 SEC 303, 311-12 (1997).

15. *See* *Regulatory Notice 13-18* (May 2013).
16. *Id*. "In order to be fair and balanced, firm communications concerning a real estate program may not include an annualized distribution rate until the program has paid distributions that are, on an annualized basis, at a minimum equal to that rate for at least two consecutive full quarterly periods."
17. IRR is also known as money-weighted returns. This can be contrasted to a time-weighted return, which is the compounded growth rate of $1 over the time period. Average annual total returns used by mutual funds pursuant to SEC Rule 482 are an example of time-weighted returns. Time-weighted returns ignore the size and timing of investment cash flows and therefore provide a measure of manager or strategy performance, while IRR measures how a specific portfolio performed in absolute terms.
18. The CFA Institute is a global association of investment professionals. *See generally* CFA Institute Global Investment Performance Standards.