

Principal Approval of Sales Material

SEC Approves Amendment to NASD Rule 2210 to Create an Exception to the Principal Approval Requirements for Certain Filed Sales Material

Effective Date: March 26, 2008

Executive Summary

Effective March 26, 2008, principal approval is no longer required for certain previously filed sales material. The amendment to NASD Rule 2210 also codifies FINRA staff's interpretation that a firm must maintain records of advertisements, sales literature and independently prepared reprints for a period beginning on the date of first use and ending three years after the date of last use. The changes to Rule 2210 are set forth in Attachment A.

Questions concerning this *Notice* should be directed to Thomas A. Pappas, Vice President and Director, Advertising Regulation, at (240) 386-4553; or Joseph P. Savage, Vice President and Counsel, Investment Companies Regulation, at (240) 386-4534.

Background & Discussion

NASD Rule 2210 (Communications with the Public) requires a member firm to have a registered principal approve in writing all advertisements and sales literature (collectively, "sales material") and independently prepared reprints prior to use. Firms also must file with the FINRA Advertising Regulation Department certain types of sales material, such as advertisements and sales literature concerning mutual funds or variable insurance products.

March 2008

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Mutual Funds
- Variable Insurance Products
- Senior Management

Key Topic(s)

- Advertisements and Sales Literature
- Principal Approval Requirements
- Recordkeeping

Referenced Rules & Notices

- NASD Rule 2210

For funds and variable products that are sold through intermediary firms, a registered principal at the fund's or variable product's underwriter typically approves sales material internally and files the material with FINRA. FINRA Rules require registered principals at each of the intermediary firms that use the underwriter's sales material to re-approve in writing each of these items used by their firms. (The intermediary firm is not required to re-file the sales material, so long as it is used without material change.) If firms have selling agreements with multiple fund families and insurance companies, the number of items that require re-approval can easily be in the hundreds, and often thousands, per firm annually.

Based on recommendations made by FINRA's Small Firms Rules Impact Task Force,¹ and to eliminate what FINRA regards as a compliance redundancy, the amendment creates an exception to Rule 2210's registered principal approval requirements for intermediary firms that use the sales material of another firm. The exception applies only to sales material that another firm has filed with FINRA, and for which FINRA has issued a review letter finding that the material appears to be consistent with applicable standards.

An intermediary firm that relies on this exception may not materially alter the sales material or use it in a manner that is inconsistent with any conditions stated in the FINRA review letter. For example, if FINRA's review letter is based in part upon the representation by the filing firm that the sales material will be accompanied by a fund prospectus, the intermediary firm would be subject to a similar constraint.

Although FINRA anticipates that firms will use the exception primarily with respect to mutual fund and variable insurance product sales material, the exception is not limited to sales material for particular products. Thus, the exception also applies to sales material for other products, such as real estate investment trusts or direct participation programs, provided that the sales material meets the exception's requirements.

FINRA believes this change will save intermediary firms time and compliance resources. Of course, the amendment would not prevent firms from continuing to review some or all of such sales material if they so choose.²

The rule change also revises certain advertising recordkeeping requirements. Rule 2210(b)(2)(A) states that firms must maintain a copy of all sales material for a period of three years from the date of last use. FINRA staff has interpreted this provision to mean that the recordkeeping requirement begins on the date of first use, and that these records must include the dates of first and (if applicable) last use. The rule change codifies this position. Firms that are relying on the principal approval exception must keep a record of the name of the firm that filed the sales material and a copy of the related FINRA review letter.

Endnotes

- 1 NASD established the Small Firms Rules Impact Task Force in September 2006 to examine how existing NASD Rules impact smaller firms. In particular, the Task Force focused on possible opportunities to amend or modernize certain conduct rules that may be particularly burdensome for small firms, where such changes are consistent with investor protection and market integrity.
- 2 The rule change does not affect the contractual obligations that exist between underwriters and intermediary firms. Some dealer agreements may, for example, restrict the ability of underwriters and product wholesalers to send their sales material directly to an intermediary firm's sales force. These restrictions can facilitate the intermediary firm's ability to supervise its sales force. The rule change does not alter the underwriter's obligations to comply with these contractual restrictions.

ATTACHMENT A

New language is underlined; deletions are in brackets.

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2000. BUSINESS CONDUCT

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2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC

2210. Communications with the Public

(a) No Change.

(b) Approval and Recordkeeping

(1) Registered Principal Approval for Advertisements, Sales Literature and Independently Prepared Reprints

(A) A registered principal of the member must approve by signature or initial and date each advertisement, item of sales literature and independently prepared reprint before the earlier of its use or filing with NASD's Advertising Regulation Department ("Department").

(B) With respect to debt and equity securities that are the subject of research reports as that term is defined in Rule 472 of the New York Stock Exchange, [this requirement] the requirements of paragraph (A) may be met by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange.

(C) A registered principal qualified to supervise security futures activities must approve by signature or initial and date each advertisement or item of sales literature concerning security futures.

(D) The requirements of paragraph (A) shall not apply with regard to any advertisement, item of sales literature, or independently prepared reprint if, at the time that a member intends to publish or distribute it:

(i) another member has filed it with the Department and has received a letter from the Department stating that it appears to be consistent with applicable standards; and

(ii) the member using it in reliance upon this paragraph has not materially altered it and will not use it in a manner that is inconsistent with the conditions of the Department's letter.

(2) Record-keeping

(A) Members must maintain all advertisements, sales literature, and independently prepared reprints in a separate file for a period beginning on the date of first use and ending three years from the date of last use. The file must include:

(i) a copy of the advertisement, item of sales literature or independently prepared reprint, and the dates of first and (if applicable) last use of such material;

(ii) the name of the registered principal who approved each advertisement, item of sales literature, and independently prepared reprint and the date that approval was given, unless such approval is not required pursuant to paragraph (b)(1)(D); and

(iii) for any advertisement, item of sales literature or independently prepared reprint for which principal approval is not required pursuant to paragraph (b)(1)(D), the name of the member that filed the advertisement, sales literature or independently prepared reprint with the Department, and a copy of the corresponding review letter from the Department.

(B) No Change.

(c) through (e) No Change.