

September 1, 2016

Mr. Robert W. Errett  
Deputy Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

**Re: File No. SR-FINRA-2016-018 (Proposed Rule Change to Amend FINRA Rules 2210, 2213 and 2214)**

Dear Mr. Errett:

This letter responds to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) to the above-referenced rule filing that would amend FINRA Rules 2210 (Communications with the Public), 2213 (Requirements for the Use of Bond Mutual Fund Volatility Ratings) and 2214 (Requirements for the Use of Investment Analysis Tools).

The Commission published the proposed rule change for public comment in the Federal Register on June 15, 2016.<sup>1</sup> The Commission received five comment letters directed to the rule filing.<sup>2</sup> Four commenters generally supported the proposal, but had some suggestions for changes.<sup>3</sup> PIABA generally opposed the proposal.

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<sup>1</sup> See Securities Exchange Act Release No. 78026 (June 9, 2016), 81 FR 39081 (June 15, 2016) (Notice of Filing of File No. SR-FINRA-2016-018).

<sup>2</sup> See Letter from Hugh Berkson, Public Investors Arbitration Bar Association, to Robert W. Errett, Deputy Secretary, SEC, dated July 5, 2016 (“PIABA”); letter from Alexander C. Gavis, Fidelity Investments, to Robert W. Errett, Deputy Secretary, SEC, dated July 6, 2016 (“Fidelity”); letter from Dorothy Donohue, Investment Company Institute, to Robert W. Errett, Deputy Secretary, SEC, dated July 6, 2016 (“ICI”); letter from Timothy W. Cameron and Lindsey Weber Keljo, Securities Industry and Financial Markets Association, to Robert W. Errett, Deputy Secretary, SEC, dated July 6, 2016 (“SIFMA”); letter from Erica A. Green, FOLIO<sup>fn</sup> Investments, Inc., dated July 7, 2016 (“Folio”).

<sup>3</sup> See Fidelity, Folio, ICI and SIFMA.

The following are FINRA's responses, by topic, to the commenters' material concerns.

#### Continuation of Retrospective Review

While Fidelity and the ICI generally supported the proposal, they both encouraged FINRA to continue its retrospective review of its rules governing communications with the public to address other areas. Fidelity recommended that FINRA update its rules governing social media, mobile devices, and electronic communications, to address the amount of disclosure FINRA requires in print advertising, and to eliminate to the extent possible differences among the rules governing broker-dealer and investment adviser communications, particularly with respect to communications containing projections or performance information. The ICI recommended that FINRA codify a set of clear disclosure standards for closed-end fund marketing materials and to eliminate the filing requirement for these communications.

FINRA continues to consider additional action on its retrospective review of the communications rules, including those raised by commenters on this proposal.

#### New Member Filing Requirements

FINRA Rule 2210(c)(1)(A) currently requires new FINRA members to file with FINRA retail communications used in any electronic or other public media at least 10 business days prior to use. This requirement extends for one year from the effective date of the firm's membership. This new firm filing requirement only applies to broadly disseminated retail communications, such as generally accessible websites, print media communications, and television and radio commercials. The proposal would modify this requirement to permit new members to file these retail communications within 10 business days of first use for a one-year period, rather than requiring these filings at least 10 business days prior to use.<sup>4</sup>

PIABA strongly opposed the proposed change to the new member filing requirement. PIABA stated that the proposed change would eliminate the pro-active investor protection that the current rule affords customers, and that post-use review of all new member retail communications by FINRA will not provide adequate investor protection for customers. PIABA also argued that the pre-use filing requirement

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<sup>4</sup> The proposed change also would delete as redundant current rule text that permits a new member to file a retail communication that is a free writing prospectus filed with the SEC pursuant to Securities Act Rule 433(d)(1)(ii) within 10 business days of first use rather than at least 10 business days prior to first use.

provides a deterrent effect to potential bad actors, and that a post-use filing requirement would embolden new members to prepare riskier retail communications.<sup>5</sup>

Folio supported the proposed change to the new member filing requirement from a pre-use to a post-use requirement, but argued that FINRA should go further and eliminate the filing requirement altogether in some circumstances. Folio asserted that other rules and requirements currently in place are sufficient to offer the important investor protections contemplated by the new member filing requirement. Folio cited as an example FINRA's new member application process pursuant to NASD Rule 1013. Folio suggested that FINRA impose the filing requirement only on new members that do not have compliance or supervisory personnel with at least five years of experience directly related to sales practice requirements that would be responsible for reviewing and approving the firm's retail communications. Alternatively, Folio suggested narrowing the new member filing requirement to exclude generic retail communications and retail communications that contain non-predictive narrative descriptions.

Upon consideration of the comments, FINRA has determined not to amend its current new member filing requirements at this time. While FINRA believes that it is a close balance between the investor protection benefits provided by pre-use review and the burden of complying with the existing rule, FINRA believes that it is more prudent to defer making the change to post-use filing of new member retail communications at this time. FINRA will continue to accumulate more data on the frequency and types of revisions required for new member retail communications before determining whether to consider any changes to this requirement in the future.

As for Folio's comments, the current rule already contains a mechanism to provide regulatory relief in the kinds of circumstances Folio cited. FINRA is authorized conditionally or unconditionally to grant an exemption from the new member filing requirement for good cause shown.<sup>6</sup> Thus, if a member makes a persuasive case that the new member filing requirement should not apply to the firm, such as where the new firm is the successor to an existing firm and its compliance personnel have demonstrated familiarity with the communications rules, FINRA may consider granting an exemption from this filing requirement. In addition, even new members are not required to file retail communications that do not make a financial or

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<sup>5</sup> PIABA also criticized the proposed changes to the new member filing requirement based on the apparently mistaken belief that the proposal would differentiate its application between new member websites, and other widely disseminated retail communications. Although an earlier version of the proposal contained such a distinction, the version filed with the SEC for comment did not.

<sup>6</sup> See FINRA Rule 2210(c)(9)(A).

investment recommendation or otherwise promote a product or service of the member.<sup>7</sup> Thus, truly generic, non-promotional retail communications need not be filed under this requirement.

#### Investment Company Shareholder Reports

FINRA currently requires members to file the management's discussion of fund performance ("MDFP") portion of a registered investment company shareholder report if the report is distributed or made available to prospective investors. FINRA proposes to exclude from the FINRA filing requirements the MDFP by adding an express exclusion for annual or semi-annual reports that have been filed with the SEC in compliance with applicable requirements.

The ICI and SIFMA supported this proposed change. SIFMA noted that this exclusion would make FINRA's rule less burdensome on asset management firms by eliminating redundant filing requirements. PIABA opposed this change on the ground that the SEC staff does not fully review all regulatory filings made on the EDGAR system, which is where filings of fund shareholder reports are made.

FINRA maintains that the MDFP portion of shareholder reports should be excluded from the filing requirements. FINRA has found through its filing program that the MDFPs in shareholder reports rarely have raised issues requiring members to revise or withdraw reports from circulation. In addition, while the SEC staff may not review all securities-related filings contemporaneous with their submission, the staff can review higher risk communications as needed. FINRA believes that this change would not appreciably impact investor protection and would allow FINRA to allocate its staff resources more efficiently to focus on reviewing higher risk communications more expeditiously.

#### Generic Investment Company Communications

FINRA Rule 2210(c)(3)(A) requires members to file within 10 business days of first use retail communications "concerning" registered investment companies. FINRA proposes to revise this filing requirement to cover only retail communications that promote a specific registered investment company or family of registered investment companies. Thus, members would no longer be required to file generic investment company retail communications.

Folio and SIFMA supported this proposed change. However, SIFMA requested that FINRA clarify how this filing exclusion interrelates with Securities Act Rule 482.

In response to SIFMA's inquiry, FINRA intends the registered investment company filing requirement to apply to any retail communication that is governed by

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<sup>7</sup> See FINRA Rule 2210(c)(7)(C).

either Securities Act Rule 482 or Investment Company Act Rule 34b-1, or that otherwise promotes or recommends a specific registered investment company or family of registered investment companies. To the extent that a retail communication qualifies as a generic investment company advertisement under Securities Act Rule 135a, a member would not be required to file the retail communication.

#### Filing Exclusion for Templates

Under current rules, members are not required to file retail communications that are based on templates that were previously filed with FINRA but changed only to update recent statistical or other non-narrative information.<sup>8</sup> However, members are required to re-file previously filed retail communications that are subject to filing under FINRA Rule 2210(c) to the extent that the member has updated narrative information contained in the prior filing.

The proposal would expand the template filing exclusion also to allow members to include updated non-predictive narrative descriptions of market events that occurred during the period covered by the communication and factual descriptions of portfolio changes without having to re-file the template. Similarly, a template could include information that is sourced from a registered investment company's regulatory documents filed with the SEC without triggering a requirement to re-file.

Fidelity and the ICI both supported this proposed change, but recommended amending the proposal. Fidelity recommended that the exclusion cover any non-predictive narrative information that comes from either an independent data provider or is sourced from an investment company's regulatory documents filed with the SEC. Fidelity recommended that, at the very least, this filing exclusion cover non-predictive narrative information that is (1) purchased or licensed directly from a third-party data provider, and (2) sourced from an SEC document.

The ICI recommended that the filing exclusion cover modifications limited to narrative factual changes provided by any "ranking entity," as such term is defined in FINRA Rule 2212(a). The ICI also recommended that FINRA broaden the reference to "non-predictive narrative information that describes market events" to expressly permit commentary. The ICI argued that otherwise the proposal could be unduly narrow and difficult for members to apply.

PIABA opposed this change, arguing that FINRA should review any narrative descriptions included in retail communications for misleading information. PIABA cited several recent enforcement cases involving misleading retail communications as grounds for maintaining FINRA's current template filing exclusion.

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<sup>8</sup> See FINRA Rule 2210(c)(7)(B).

FINRA disagrees that Rule 2210 should exclude from filing any template updates that are based on any non-predictive narrative information that is sourced from an independent data provider. FINRA believes that such a standard could potentially permit inclusion of non-predictive narrative information that is intended to promote future sales of a fund, which FINRA believes should be re-filed. However, if a member updates a template based on information that is sourced from a registered investment company's regulatory documents filed with the SEC, the update would qualify for this filing exclusion. This exclusion would apply even if an independent data provider supplies the information that is sourced from SEC filings.

FINRA does not agree that the template filing exclusion should be based on whether narrative factual changes are provided by a ranking entity as defined in Rule 2212. FINRA believes that the better test is whether the information is sourced from SEC filings, rather than basing it on the provider's business model.

FINRA does not agree that the template filing exclusion also should cover commentary. As ICI acknowledged, commentary often includes forward looking statements about the market or a particular fund. Accordingly, FINRA believes these kinds of narrative updates should be re-filed.

FINRA does not believe the cases cited by PIABA support its position that the template filing exclusion should not be revised. The cases did not involve updates of templates, but rather instead involved misleading marketing materials that members would continue to have to file even after the proposed change to the template filing exclusion. Members are already required to file mutual fund retail communications, and to the extent a member is using a retail communication that becomes misleading due to changes in market conditions, the member must either cease using the communication or revise the communication to make it accurate. If the revision constitutes a material change to the retail communication, the member must re-file it.<sup>9</sup>

Moreover, the FINRA Rule 2210 content standards apply regardless of whether a member re-files a retail communication with FINRA. FINRA believes existing standards, even after this change to the template filing exclusion, strongly protect retail investors from potentially misleading communications. Accordingly, FINRA is not revising its proposed changes to the template filing exclusion.

#### Bond Fund Volatility Ratings

FINRA Rule 2213 permits members to use communications that include ratings provided by independent third parties that address the sensitivity of the net asset value of a bond mutual fund's portfolio to changes in market conditions and the general economy, subject to a number of requirements. These requirements include that the communication be accompanied or preceded by the fund's prospectus, that it

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<sup>9</sup> See FINRA Rule 2210(c)(7)(A).

be filed at least 10 business days prior to use with FINRA, and that it include a number of disclosures. FINRA has proposed to revise these requirements by no longer requiring such communications to be accompanied or preceded by a fund prospectus, by allowing members to file such communications within 10 business days of first use rather than 10 days prior to use, and by streamlining some of the content standards and required disclosures.

PIABA opposed these changes on the ground that recent enforcement actions involving the sale of bond funds demonstrate that bond funds should be highly regulated. While FINRA agrees that bond funds and members' sales of such funds should be effectively regulated, it disagrees that the proposed changes would undermine this goal. PIABA does not allege that any of its cited cases involved communications that included bond fund volatility ratings, nor has FINRA taken any enforcement actions involving violations of FINRA Rule 2213.

In addition, the proposed changes would not alter a member's obligation to file retail communications concerning bond mutual funds. The only filing change would be that retail communications that included a bond fund volatility rating would have to be filed within 10 business days of first use, similar to any other retail communication concerning a specific fund or fund family, rather than at least 10 business days prior to use. Rule 2213 also would continue to impose content and disclosure requirements that will provide investors with significant information about the meaning and limitations of volatility ratings.

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FINRA believes that the foregoing responds to the material issues raised by the commenters to the rule filing. If you have any questions, please contact me at (240) 386-4534, email: [joe.savage@finra.org](mailto:joe.savage@finra.org). The fax number of the Office of Regulatory Policy is (240) 386-4572.

Best regards,

/s/ Joseph P. Savage

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