

March 27, 2017

FINRA
Marcia E. Asquith
Office of the Corporate Secretary FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 17-06: Communications with the Public

Dear Ms. Asquith,

I am writing to you today on behalf of the Third-Party Marketer's Association ("3PM") to express the thoughts and concerns of our association regarding the draft provisions proposed in FINRA Regulatory Notice 17-06. While it is our goal to respond to requests for comments in a manner beneficial to the majority of 3PM's members, it should be noted that the views of the commenters involved in preparing this response may not be representative of the views of the entirety of the 3PM membership or our industry group in general.

3PM believes that the initiation of a retrospective rule review is a prudent step to ensure that regulations remain relevant in a changing environment. In this regard, we applaud the steps FINRA is taking in this regard. We do also believe, however, that with respect to RN 17-06 and the amendments contemplated under this notice, that FINRA has not fully and appropriately updated the Communications with the Public standards to properly reflect the realities occurring in the marketplace.

While 3PM's members operate under a varied set of business models, approximately 2/3s of the Association's 3PM members engage in the business of offering of private funds to institutional investors. It is for this subset of our membership for which we will be commenting to this Regulatory Notice.

Rule 2210

FINRA Rule 2210 provides that communications may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. Regulatory Notice 17-06 goes on to state that "The general prohibition against performance projections is largely intended to protect retail investors from performance projections of individual investments, which often prove to be spurious, inaccurate or otherwise misleading".

RN 17-06 is proposing to provide an exception to this prohibition of projections for a hypothetical investment planning illustration. 3PM believes that the exception proposed by RN 17-06 is warranted, but requests further analysis to consider an exception to the prohibition of projections when offering private securities to institutional investors. 3PM believes that an exception of this nature is consistent with the spirit of the proposed amendment as well as with prevailing guidance as detailed below.

Precedent to Support our Thesis

In general, FINRA Rule 2210 correctly acknowledges the reality that business conducted with institutional investors is different than business conducted with retail investors. Under this rule, the differences inherent in these two investor groups are addressed; communications with retail investors require more stringent supervision and often pre-approval while institutional communications do not. While we believe that FINRA's decision to segregate this rule into components that provide adequate protection to each type of investor based on their experience and knowledge of investments is appropriate, we question why this standard was not applied to the rule in its entirety.

Furthermore, the suitability rule, FINRA Rule 2111, another sales practice rule, also differentiates the suitability process by retail investors and institutional investors. While documentation and suitability assessments for retail investors is very detailed, the approach for institutional investors is more streamlined and straightforward. This again reinforces the belief that retail investors require far more protection than institutional investors who are better able to assess an investment than their less experienced counterparts.

Additionally, FINRA has issued several interpretative letters that support this assertion. One example of this is evident in the letter issued to Mr. Budge Collins of Collins/Bay Island Securities (9/14/2004) regarding the "Use of related performance information in communications with the Public for Private Funds". The response to Mr. Collins, in-part, states "NASD staff believes that the presentation of related performance information to potential investors in 3(c)(7) funds, who are 'qualified purchasers', does not present the same investor protection concerns as the presentation of related performance information in other contexts."

Given the precedent that exists, we believe that FINRA should expand this approach, which is already applied in the same rule, to the prohibition of 'projected performance' discussed in this regulatory notice.

Retail vs. Institutional Investors

It is important to note that in the institutional arena there are a variety of inputs that investor use to determine whether an investment should be considered and ultimately whether an investment should be made. Projected performance is just one part of the equation.

When looking for an investment, investors, specifically institutional investors, want to be able to tell immediately if an investment warrants a further look. Today, when investors are inundated with product, they need a mechanism by which they can shrink down the enormous universe of investments into a small sub-set of strategies at which they can look at more closely. Projected performance is one of the ways they do this.

Once an institutional investor decides to look further at a security, a formal review begins. The due diligence process used by institutional investors is quite exhaustive. While it may differ somewhat by investment product, there are, however, four underlying areas of focus that all institutional investors review before making a judgement on the attractiveness of any investment product.

- First, it starts with an examination of the PEOPLE at the investment manager responsible for the product. Do they have adequate investment knowledge and familiarity with the offered product? How long has the team been working together and do they have any conflicts of interest with investors?
- Second, the institutional investor examines the PHILOSOPHY underlying the investment. Is it a well-articulated investment strategy? Can it be documented; does it make sense? Is there a consistent adherence to the strategy?
- Third, is an evaluation of the PROCESS or investment decision making. Who makes investment decisions? How are they generated, researched, pursued and screened? What are the lines of authority, responsibility and accountability?
- Fourth, is a full evaluation of PERFORMANCE, not just the projected performance. Were the results produced by current people utilizing current process? Was there a review an analysis of funds and benchmark with similar objectives and characteristics?

Institutional Investors realize that market conditions change and that past performance is not that reliable when trying to determine future expected returns. However, past performance may be helpful to complement or strengthen the institution's favorable evaluation of an investment manager's product.

Fund Projections

To understand why we think performance projections should be permitted, it is important to understand how investment managers offering private securities develop performance projections for their funds. Projected performance is not an arbitrary number that is pulled out of thin air, but rather a systematic derivation of several factors that combined result in that projection. It is the rate of return that the investment manager believes is achievable in light of their strategy, current market conditions and its deal flow.

To calculate performance of a Fund of alternative investments, the manager will calculate the Internal Rate of Return (IRR) for each investment in the fund. IRR is defined as the discount rate at which the net present value of a set of cash flows equals zero, where the initial investment is expressed negatively and the returns from real estate investments are expressed positively. In more simple terms, it is the rate at which an investment grows. In this sense, you can think of it as a time sensitive compounded annual rate of return.

For example, please consider an investment manager who is raising capital for a single investment, say an apartment complex. To calculate projected performance, the investment manager will calculate the IRR on the project given the costs of the project relative to the projected revenue it will receive from each investment. The inputs to the process are based on current and historical facts and figures, assumptions that could impact either the cost or revenue of the project as well as the managers experience in the industry. Generally, a formal model that outlines the inputs and assumptions is developed and provided to potential investors who are contemplating an investment. Forecasting returns in this manner is an important component of the investment decision-making process.

As with all investments, the projected performance is not a guarantee that the investment will return a certain percentage, but rather it is an estimate of the return that can be expected. Private Placement Memorandums (PPMs) inherent to the offering of any private security contain disclosures, often with emphasis, stating that there is no guarantee the investment will earn a certain return or that past performance is indicative of future returns. These projected returns are alternatively meant to help the investor determine whether the risks of the investment are justified by the potential rate of return and to compare other potential investments the investor is considering.

When looking at a Fund investment the process is similar although a bit more complex considering the Fund will invest in multiple projects, properties, companies or investments at the same time.

To determining the projected return of the Fund, an investment manager will often start with actual fund performance of its predecessor fund. The manager will then consider other inputs such as the size of the fund, terms of the current fund compared to past funds, current market conditions affecting the strategy, competition as well as any other factors that could impact the projected return.

When management of the Fund begins, the investment manager will model each investment and calculate the IRR to determine the attractiveness of the investment. If the IRR of a new investment exceeds a company's projected performance, then the investment is desirable. If IRR is below the required rate of return, the investment should be rejected.

Projected performance, is not arbitrary. It is based on hard facts. Furthermore, while most of the inputs that go into calculating the IRR are objective, an investment manager has the ability to adjust its model to account for facts that may not be evident based on historical performance.

In the Private Equity market, it is common for managers to come to market several times with funds utilizing the same investment approach. In most cases, the fund size grows each time a new fund is launched. At some point capital commitments, will grow to a point where the manager will no longer be

able to find enough suitable investments that meet its previous targeted return. In such instances, the manager must often look at other investments that are either outside his preferred criteria or that return less than his targeted return. This is often referred to as style drift.

To account for this phenomenon, a manager could adjust its projected performance to reflect this occurrence, signaling investors that something in the Fund approach has changed. Alternatively, if an investor does not have projected performance they will be forced to rely on past performance information which in this case would be misleading at best.

Use of Projected Performance

Investment managers who seek capital for their investment opportunities must be able to clearly and concisely convey their investment thesis and strategy and describe how that process has generated its historical track record. Projected performance is the way investment managers encapsulate all of these factors into a number that accurately and concisely represents their product. This is just one reason that projected performance has become a vital component of modern day investment analysis. Given the importance of this projected performance, calculations of such must be based on a sound and reasonable methodology. This explains why investment managers are constantly developing and refining these figures for accuracy through comprehensive scenario analysis.

Alternatively, institutional investors require projected performance from any of the multitude of investment opportunities available to them. Finite resources such as time and capital dictate that institutional investors employ effective filtering tools to distill large numbers of prospective investment opportunities to a manageable target universe that may ultimately lead to an allocation or two. One of the most common filters used by institutional investors is the data point of projected performance.

Institutional investors that utilize projected performance also pay close attention to the pro forma analysis which generally accompanies closed-end structured investment vehicles or securities such private equity and real estate. These forward-looking performance projections as well as the underlying methodology used to calculate the performance allow institutional investors to gauge a fund's approach. Simply put, institutional investors use performance projections to weigh the risk/reward attributes of a strategy and assist in understanding a variety of hypothetical illustrations used in the scenario analysis. This information enables the institutional investor to analyze, compare and determine their focus on each investment opportunity accordingly. Comparative analysis is commonly used by institutional investors and projected performance of various investments is what they are comparing.

Given the realities of the market, we believe that a general prohibition on the use of projected performance is unnecessarily restrictive.

Reasonable Basis

When discussing the proposed amendments, Regulatory Notice 17-06 states that “The proposal would require that there be a reasonable basis for all assumptions, conclusions and recommendations, and that the illustration clearly and prominently disclose the fact that the illustration is hypothetical and there is no assurance that any described investment performance or event will occur. All material assumptions and limitations applicable to the illustration would have to be disclosed.”

We believe that this same approach could be applied to third party marketers or placement agents soliciting investments from institutional investors when using projected performance for a fund or security they are offering. In such a case, we believe any use of projected performance should be accompanied by a clear and prominent disclosure written by the distributing broker dealer which contains the following information:

- Statement that the broker dealer believes there is a reasonable basis to believe the projected performance is representative of the security or fund it represents
- Statement that the projected performance is hypothetical and there is no assurance that any described investment performance or event will occur.
- Description of the methodology used to develop the projected performance
- Explanation as to why the methodology used is a good predictor of the projected performance of the security or fund
- All material assumptions and limitations applicable to the calculation of the projected performance

Furthermore, we believe that several of the well-established precedents cited by FINRA, in its own rules and those of the SEC, are also applicable to 3PM’s case.

To protect the institutional investors we work with, 3PM would also recommend that any projected performance along with the required disclosure, as outlined above, should also receive pre-approval, before use, by a registered principal of the broker dealer who plans to utilize this information. Given that the projected performance is likely to come from the Fund sponsor, the broker dealer’s registered principal should be tasked with determining whether there is a reasonable basis to rely on the projected performance based on the methodology, assumptions and limitations provided with the projected performance. This approach would provide an independent assessment and help mitigate the conflict of interest inherent in the fact that the Fund Sponsor is not only projecting performance but is also determining the case for why its use is “reasonable”.

Economic Impact Assessment

At the core of our assessment of economic impact is the question of common sense and fairness for the industry. Given this, we suggest a few baseline considerations in this regard:

1. In the case where 100% of the market is held to the same standard, while the economic assessment may still prove problematic, it is at least evenly applied.
2. Similarly, where rule sets are consistent across regulatory agencies in relation to the same business practice, with most firms being required to be regulated by more than one agency, economic impact is consistent.
3. If the rules provided create inconsistency among constituents and/or by regulatory body, this places a greater burden on some firms over others, which creates economic impact that is negative for many market constituents.

3PMs exist, in part, to help level the playing field – ie to assist investment managers without internal sales and marketing resources to be able to compete with those that do, obtain access to capital and to provide small managers and/or strategies newer to the market with access to a broader investor base. Our issue however, is that we ourselves are subject to an uneven playing field.

Regulation that creates inconsistency, or provides one group with an ‘advantage’ over another is harmful to 3PMs. It is also harmful to our investment manager clients, institutional investors and their constituents which include: pensioners, grant recipients, universities, charitable organizations, etc.

Should the unlevel playing field persist, 3PMs eventually will be forced to choose between exiting businesses that require more resources for a substantially lower probability of earning revenues or putting up with the disadvantages created by the regulation that is supposed to promote a fair market place for all. If investment managers who relied on 3PMs were to lose access to our services, taking many small and mid-sized managers out of consideration by institutions, the largest and most well-funded investment management firms who can ‘afford’ in house resources and sizeable infrastructures would hold a monopoly on asset gathering.

To an extent this is already the case, with larger investment managers holding a disproportionate share of institutional assets.

The unlevel playing field also hurts:

- Third party marketers who can no longer make a living due to the rising cost of regulation and the detrimental impact of Rules that prevent third party marketers from fairly competing with internal sales professionals
- investment managers who have no way to access institutional capital, will be forced to raise retail assets which is also not easy without a staff to do so

- the investment manager's staff who are out of work when the manager goes out of business because it can't raise assets and earn fees
- institutional investors who will no longer be able to access the strategies of investment managers with no internal sales support
- With no access to smaller managers, investors would be forced to invest with the largest investment managers, many of who do not offer the most competitive performance given their size
- Investments with the largest firms could impact performance causing the investor to underperform their targets
- Missing targets directly impacts the constituents of the institutional investor such as pensioners, grant recipients, universities, charitable organizations, all of whom rely on the institution for funding

It is our hope that regulators like FINRA, the MSRB and SEC will see how small businesses in the financial industry are suffering the consequences of over-regulation which leads to this uneven playing field. While regulatory support might not be the only solution, it would at least help by eliminating unreasonable restrictions on firms working with institutional investors.

Below are some examples and their related considerations:

- While we agree that past performance may not recur and thus understand the potential risk of a 'projection', we believe that this rule is actually forcing investors to rely on past performance if they do not have target returns to evaluate. In addition, the lack of a projected performance gives investors no frame of reference for performance. In some cases, it is more meaningful to provide a data based projected return which may in fact be lower than the past performance and should be in many cases.

For example, a first-time real estate Fund performed exceptionally well, generating performance around 20%. The investment manager launches a second fund using the same strategy while the market conditions have changed and have lowered the projected performance of the fund. In such a scenario, we believe that a registered representative should be permitted to provide information to a prospective investor with a more realistic projected performance range rather than let the investor believe that the higher performance earned in the first fund will persist and be generated by the second fund.

In the Private Equity market, it is common for managers to come to market several times with funds utilizing the same investment approach. In most cases, the fund size grows each time a new fund is launched. At some point capital commitments, will grow to a point where the manager will no longer be able to find enough suitable investments that meet its previous targeted return. In such instances, the manager must often look at other investments that are

either outside his preferred criteria or that return less than his targeted return. This is often referred to as style drift.

To account for this phenomenon, a manager could adjust its projected performance to reflect this occurrence, signaling investors that something in the Fund approach has changed. Alternatively, if an investor does not have projected performance they will be forced to rely on past performance information which in this case would be misleading at best.

Being allowed to discuss the targeted return for investment products and services should be permitted to at least some investors, namely institutional investors.

- Since the majority of investment managers third party marketers work with are registered with the SEC, Rules like 2210 which prohibit the use of projected performance do not apply to internal sales and marketing professionals. We believe that this creates an unfair playing field and is detrimental to the goal of fair and open markets.

Third party marketers are put at a disadvantage when offering product to investors. Fund managers and their internal employees will always discuss the targeted return of an investment. This leads to an uneven playing field in a very competitive market place where many investors will immediately pass on a product that does not show a targeted return. It may even result in the investment manager electing not to hire a Solicitor as they may view, and correctly so, the marketing effort at a disadvantage.

- Should third party marketers choose to exit this business, investment managers will need to find other avenues to offer their services to institutional investors. If this were to occur, institutional investors would have less access to the products that third-party marketers represent and the investment arena would be further monopolized by the largest firms who can afford an internal team infrastructure.

To minimize economic impact of this and subsequent regulation, 3PM suggests a review of the consistency of rules across regulatory bodies in relation to these business practices and regardless of whether the delivery of information is from an internal employee or a third-party marketer. Similarly, 3PM suggests a clear delineation between institutional and retail audiences and standards.

FINRA specifically request comments concerning the following issues:

1. In addition to the economic impacts identified in this proposal, are there other significant sources of impacts, including direct or indirect costs and benefits, of the proposed amendments to the firms and investors? What are these economic impacts and what factors contribute to them? What would be the magnitude of these costs and benefits? Please provide data or other supporting evidence.

Please see the section above entitled Economic Impact Assessment.

4. Are there other alternative approaches FINRA should consider to accomplish the goals described in this proposal? If so, what are those alternatives and why are they better suited?

In RN 17-06, FINRA states that “the general prohibition against performance projections is largely intended to protect retail investors from performance projections of individual investments, which often prove to be spurious, inaccurate or otherwise misleading”. We agree with this assessment and as such 3PM would like to see this portion of the advertising rule approached in the same manner as the rest of the Rule; namely by the same segmentation between retail and institutional investors.

Furthermore, we believe that allowing the use of projected performance when marketing securities to institutional investors would be more beneficial to investors rather than detrimental

For example, in the Private Equity market, it is common for managers to come to market several times with funds utilizing the same investment approach. In most cases, the fund size grows each time a new fund is launched. At some point capital commitments, will grow to a point where the manager will no longer be able to find enough suitable investments that meet its previous targeted return. In such instances, the manager must often look at other investments that are either outside his preferred criteria or that return less than his targeted return. This is often referred to as style drift.

To account for this phenomenon, a manager could adjust its projected performance to reflect this occurrence, signaling investors that something in the Fund approach has changed. Alternatively, if an investor does not have projected performance they will be forced to rely on past performance information which in this case would be misleading at best.

5. This Regulatory Notice includes examples of factors that would and would not provide a “reasonable basis” for performance projections under the proposal. Are the historical performance and performance volatility of asset classes appropriate factors that would provide a reasonable basis for performance projections? Are there other examples that FINRA should provide that would further clarify what would constitute a “reasonable” basis for a performance projection?

In addition to the information provided, we believe that the use of specific and relevant market indices, peer group comparisons, and other widely acceptable absolute and relative historical investment performance of a specific investment strategy should also be considered. For example, in the private equity market, it is very common to review performance on a vintage year basis. While in most cases, past performance in and of itself is not a guarantee of future performance, it is however used as a basis to compare other years of performance and to establish a base-line of performance for PE investments. Even the traditional public equity markets utilize past data to estimate the overall return on the stock market and we believe that same should hold for alternative asset classes.

6. The proposal would not permit performance projections for a single security. Securities Act Rule 156, which governs investment company sales literature, provides in part that a statement could be misleading because it includes representations about future investment performance. Are there single investment products that operate like an asset allocation or other investment strategy for which performance projections might be appropriate?

The current marketplace includes many investment products that operate and perform like an asset allocation. Nearly every type of alternative investment category has such a product. A few of the many examples that exist include the following:

- **Hedge Funds: *Multi-strategy Funds*.** Covers a variety of sub-strategies in the Hedge Fund universe. Can be used by investors to obtain broad hedge fund exposure without investing capital with managers focused in a specific sub-strategy like long/shore, market-neutral, arbitrage, Emerging Markets, Event Driven, Corporate Governance, etc.
- **Real Estate: *Core Real Estate Products*** - Covers a variety of sub-strategies in the Real Estate universe. Can be used by investors to obtain broad real estate exposure without investing capital with managers focused in a specific residential, commercial, luxury, raw land or can be used to mimic overall exposure to a sub-category like residential – which might include single family and multifamily properties.
- **Private Equity – *Core Private Equity Funds*** - Cover a variety of sub-strategies in the Private Equity universe. Can be used by investors to obtain broad exposure without investing capital with managers focused in a specific sub-strategy like venture capital, buyouts, secondaries or co-investments. Like Real Estate these funds are also further segmented and may include the various stages of a venture capital deal from early to late stage, or differentiate investments by geography, whether it be in the US, or outside the US in developed or emerging markets.
- **Infrastructure Funds.** Infrastructure Funds roll-up a variety of different strategies including Renewable Energy, Non-Renewable Energy, Utilities and Pipelines, Power Generation & Transmission, Transportation. These funds also invest in raw land, parking structures, and hospitals. Not only has infrastructure morphed into its own investment category, but some of its investments also overlap with other sector strategies such as energy. Global Funds will also differentiate investments by geography, and will include allocations to the various sectors in the US and outside the US in both developed or emerging markets.

These single investment products were all designed to provide investors with broad exposure and as such operate like an asset allocation. Given this, there is no reason to differentiate these securities from the rules that govern the performance of an asset allocation or investment strategy.

Furthermore, if these securities, given their similarities to an asset allocation of investment strategy were to be permitted to use projected performance, it would be logical to also allow other securities to use projected performance.

As discussed throughout this comment letter, we believe that performance projections should be permitted when discussing the securities offered by a private fund. We however, do not believe that these projections should be permitted across the board but rather only when the recipient of these projections is an institutional investor.

While we understand that not all institutional investors are the same and that not all are sophisticated enough to determine the appropriateness of an investment, we do believe that most either employ internal staffs that have sufficient experience to make these determinations or utilize the services of an investment consultant who help the investor select the appropriate investments.

This leaves a small group of institutional investors that might not be capable to discern the relevance or reasonableness of projected performance. These investors would, however, not be without protection. In such instances, other FINRA rules would come into play and serve to protect these investors. Some examples of these include FINRA Rule 2090 (Know Your Customer), 2111 Suitability, 2310 (Direct Participation Programs), 5123 (Private Placements of Securities) as well as the guidance provided to members in notices such as NTM 03-71 (Obligations when selling Non-Conventional Investments) and NTM 03-07 (Members Obligations when Selling Hedge Funds).

Given the above we believe that there is a rationale case to permit the use of performance projections when offering securities offered by private funds to institutional investors.

7. The proposal would permit a single projection in a customized hypothetical investment planning illustration. Requiring a range for projections, however, could make the hypothetical nature of a performance projection more apparent. Should the proposal require a range of projections?

While most private Fund Sponsors generally determine a single projection for performance, we would not be averse to insisting that the Fund Sponsors we work with provide a range of projections for performance if FINRA were to consider allowing member firms working with institutional investors as third party solicitors to utilize performance projections.

In addition, we feel that the use of performance projections should be accompanied by a clear and clear and prominent disclosure written by the distributing broker dealer. This coupled with the requirement that performance projections be pre-approved, prior to use, by a registered principal of the broker dealer who plans to utilize this information, would serve to protect institutional investors.

Please see the section above titled "Reasonable Basis" for a further discussion on 3PM's thoughts on disclosure requirements and Principal approval of projected performance.

Thank you for the opportunity to share our thoughts with you regarding this proposal. Please feel free to reach out to me at (585) 364-3065 or by email at donna.dimaria@tesseracapital.com should you have any questions or require additional information pertaining to the proposed amendments to the Communication with the Public rule.

Regards,

<<Donna DiMaria>>

Donna DiMaria
Third Party Marketers Association
Chairman of the Board of Directors and
Chair of the 3PM Regulatory Committee

About the Third-Party Marketer's Association (3PM)

3PM is an association of independent, global outsourced sales and marketing firms that support the alternative and traditional investment management industry worldwide.

3PM Members are properly registered and licensed organizations consisting of experienced sales and marketing professionals who come together to establish and encourage best practices, share knowledge and resources, enhance professional standards, build industry awareness and generally support the growth and development of professional outsourced investment management marketing.

Members of 3PM benefit from:

- Regulatory Advocacy
- Best Practices and Compliance
- Industry Recognition and Awareness
- Manager Introductions
- Educational Programs
- Online Presence
- Conferences and Networking
- Service Provider Discounts

3PM began in 1998 with seven member-firms. Today, the Association has more than 35 member organizations, as well as significant number of prominent firms that support 3PMs and participate in the Association as 3PPs, Industry Associates, Member Benefit Providers, Media Partners and Association Partners.

A typical 3PM member-firm consists of two to five highly experienced investment management marketing executives with, on-average, more than 10 years' experience selling financial products in the institutional and/or retail distribution channels. The Association's members run the gamut in products they represent. Members work with traditional separate account managers covering strategies such as domestic and international equity, as well as fixed income. In the alternative arena, members represent fund products such as mutual funds, hedge funds, private equity, fund of funds and real estate. Some firms' business is comprised of both types of product offerings. Most 3PM's members are currently registered with FINRA or affiliated with a broker-dealer that is a member of FINRA.

For more information on 3PM or its members, please visit www.3pm.org.