

Client Alert

Current Issues Relevant to Our Clients

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FINRA Allows Related Account Performance Information in Communications with Institutional Investors

The Financial Industry Regulatory Authority (“FINRA”) recently issued an interpretive letter that allows distributors of mutual funds to include related performance information in communications with institutional investors, including registered broker-dealers and investment advisers. This information is actual past performance of similar separate or private accounts or funds managed by a fund’s manager. Institutional communications that include related performance information are subject to certain conditions, including specified disclosure requirements. This letter represents a shift from FINRA’s prior position that inclusion of related performance information in such communications would violate the content standards found in FINRA Rule 2210. You may obtain a copy of the full interpretive letter [here](#).

Background

FINRA Rule 2210 governs members’ communications with the public, including institutional marketing and advertising material. Section (d) of FINRA Rule 2210 imposes content standards on any communication subject to the Rule. While the Securities and Exchange Commission (“SEC”) has allowed the use of related performance information in mutual fund prospectuses in certain situations for some time, FINRA has historically taken the position that the presentation of related performance information in advertising and sales literature would violate the content standards in all but a limited number of circumstances. For example, a new fund’s prospectus often includes the fund advisor’s separately-managed account composite performance for a similar managed account strategy but the fund is generally not permitted to include that same information in advertising for the fund.

In 2003, FINRA issued an interpretive letter that stated that FINRA would not object to including related performance information in sales materials for private funds relying on Section 3(c)(7) of the Investment Company Act of 1940 (the “1940 Act”) if that information was made available only to “qualified purchasers” as defined in the 1940 Act. In a separate 2003 interpretive letter and a 2004 interpretive letter, FINRA indicated that use of related performance information was limited to communications with regard to 3(c)(7) funds and qualified purchasers.

In its most recent letter, FINRA reversed its historical position on use of related performance information to a limited but meaningful extent. FINRA applied the same

rationale used in its 2003 interpretive letter to conclude that communications regarding mutual funds that include related performance information are consistent with the applicable standards of FINRA Rule 2210 when limited to institutional investors and subject to certain other conditions. This letter did not affect FINRA’s longstanding position that the presentation of related performance information in communications used with retail investors does not comply with FINRA Rule 2210(d).

What Is Related Performance Information?

The interpretive letter defines “related performance information” as actual performance of all separate or private accounts or funds that (i) have 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.

The FINRA interpretive letter defines “related performance information” with specific reference to “mutual funds”. The term “mutual fund” is not a legal term and is not defined in either the FINRA rules or the interpretive letter. The 1940 Act generally breaks investment companies into management companies and unit investment trusts. Management companies are further broken into open-end companies and closed-end companies. The term “mutual fund” is frequently, but not always, used to describe funds that are registered as open-end companies. The substantive interpretation in the FINRA letter should logically apply to any registered investment company as long as the performance information otherwise satisfies

the substantive components of the definition of “related performance information” in the letter and the fund can comply with the conditions described below. However, the FINRA letter itself does not clarify the applicability of the interpretation.

Who Can Receive Related Performance Information?

The interpretive letter limits distribution of related performance information to persons who qualify as “institutional investors” under FINRA Rule 2210(a)(4). This means that this information may only be distributed to:

- banks, savings and loan associations, insurance companies or other registered investment companies;
- investment advisers registered either with the SEC or with a state securities commission;
- other persons (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million;
- governmental entities or subdivisions thereof;
- certain employee benefit plans and qualified plans (but not participants in the plans);
- FINRA member firms or their registered persons; and
- persons acting solely on behalf of any such institutional investor.

FINRA Rule 2210(a)(4) also expressly provides 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.

Conditions For Including Related Performance Information

FINRA conditioned the use of related performance information in institutional communications on the member presenting such information under the following conditions:

- The performance information may be provided only if it is actual performance of all separate or private accounts or funds that (i) have substantially similar investment policies, objectives, and strategies, and (ii) are 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.

- Materials with related performance information must only be provided to persons who qualify as “institutional investors” under FINRA Rule 2210(a)(4), other than institutional investors that intend to share the information with persons other than “institutional investors.”
- The presentation of related performance information must include all accounts or funds described in the first condition (“*related accounts*”). If there are multiple related accounts, the investment performance of such accounts must be presented in a composite or a list and displayed with equal prominence.
- Any institutional communication must be clearly labeled “for use with institutions only, not for use with retail investors.” Institutional investors who receive such materials must be instructed not to provide them to current or prospective customers or others who are not institutional investors.
- The presentation of related performance information must disclose performance information that is net of fees and expenses of related accounts, or net of a model fee that is the highest fee charged to any account managed in the strategy. If gross performance information is also provided, the institutional communication must prominently disclose that (i) the performance information does not reflect the deduction of fees and expenses, (ii) different funds and accounts have different fees and expenses, and (iii) the related performance information would have been lower to the extent the related funds or accounts were subject to higher fees and expenses. The fees and expenses of the registered fund that is the subject of the institutional communication must be prominently disclosed and this fund’s performance information must reflect all fees and expenses. If the fees and expenses are higher than the fees and expenses of the related accounts, that fact must be disclosed.
- Related performance information must (i) include the performance for each related account, (ii) be for a period of at least one year and since the inception of the investment strategy and (iii) be current as of the most recently-ended calendar quarter.
- Related performance information must be clearly labeled as such and contain clear disclosure of the applicable dates for the performance.
- For a mutual fund in existence for more than one year, its actual performance must be displayed more prominently than the related performance information.
- The institutional communications must disclose any material differences between the funds or accounts for which related performance information is provided

and the mutual fund that is the subject of the institutional communication.

- All institutional communications that contain related performance information must comply with all other applicable FINRA rules and federal securities laws and be subject to the same supervisory requirements as all other firm communications.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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