

Client Alert

Current Issues Relevant to Our Clients

April 2, 2014

SEC Seeks Comments on Revised FINRA Advertising Rules—Listed Security Research and Certain Free Writing Prospectuses

The Financial Industry Regulatory Authority, Inc. (“FINRA”) recently filed proposed advertising rule changes with the Securities and Exchange Commission (“SEC”). The SEC is now seeking comments on the proposed rule changes. The proposed amendments would:

- eliminate FINRA Rule 2210 filing requirements for research reports concerning only securities listed on a national securities exchange (other than certain research reports filed pursuant to the Investment Company Act of 1940 (the “1940 Act”));
- clarify that free writing prospectuses that are exempt from filing with the SEC are not subject to the FINRA Rule 2210 filing or content standards; and
- correct a mistaken rule cross-reference in FINRA Rule 2214 on investment analysis tools.

The SEC notice describing the changes is available [here](#). You may submit comments on the proposed rule changes through April 21, 2014 by various methods, including using [this link](#).

Background

Over the last several years, FINRA has updated and revised old NASD rules governing broker-dealer communications with the public. Among other things, the adoption of FINRA Rule 2210 required for the first time that member firms file with FINRA’s Advertising Regulation Department all retail communications concerning closed-end funds registered under the 1940 Act. The prior rule change also required that firms file all retail communications concerning any security that is registered under the Securities Act of 1933 (the “Securities Act”) and is derived from or based on a single security, basket of securities, index, commodity, debt issuance or foreign currency. This filing requirement was aimed at “structured products”, although its breadth is arguably broader. The FINRA Rule 2210 filing requirements also cover research reports about exchange-listed securities, such as exchange-listed master limited partnerships and registered closed-end funds. For further discussion of FINRA’s rules governing broker-dealer communications with the public, please see our Client Alerts on the original 2012 rule approval available [here](#) and on additional 2013 FINRA guidance available [here](#).

Proposal to Eliminate Filing Requirement for Research Reports on Exchange-Listed Securities

The FINRA proposal would amend FINRA Rule 2210 to exclude from the filing requirements research reports concerning only securities listed on a national securities exchange. FINRA Rule 2711 defines “research report” to include any written (including electronic) communication that includes analysis of equity securities of individual companies or industries and provides information reasonably sufficient upon which to base an investment decision. The amendment would not exempt research reports subject to Section 24(b) of the 1940 Act (registered open-end funds, unit investment trusts, face-amount certificate companies and the underwriters for such companies).

FINRA believes that the likelihood of investor harm resulting from the distribution of research reports concerning only exchange-listed securities is significantly lessened for a variety of reasons. For example, research reports are subject to separate comprehensive disclosure, content and analyst independence requirements under NASD Rule 2711 and SEC Regulation AC (Analyst Certification) and the nature of being listed on a national

securities exchange reduces the risk that a research report could manipulate a security's trading price.

At this time, FINRA is not proposing to exclude research reports concerning unlisted securities for various reasons, including that those securities do not possess the same liquidity and price discovery features of exchange-listed securities. The proposed filing exclusion also would not apply to retail communications concerning an exchange-listed security that are not "research reports" for purposes of NASD Rule 2711 because the additional investor protections that apply to research reports do not apply to such retail communications.

Clarification on Free Writing Prospectuses Exempt from SEC Filing

The filing and content requirements of FINRA Rule 2210 do not apply to most prospectuses, preliminary prospectuses, fund profiles, offering circulars and similar documents that have been filed with the SEC, including "issuer free writing prospectuses" that are filed with the SEC. Questions have arisen as to whether these exclusions also cover free writing prospectuses that are exempt from filing with the SEC. The FINRA proposal would amend Rule 2210 to specifically exclude from the filing and content standards free writing prospectuses that are exempt from SEC filing to clarify this issue. The FINRA filing and content requirements will continue to apply to (a) investment company ads under Securities Act Rule 482 and (b) free writing prospectuses used by underwriters and broker-dealers that are distributed in a manner reasonably designed to lead to broad unrestricted dissemination even though these are required to be filed with the SEC under Securities Act Rule 433(d)(1)(ii).

Cross-Reference Correction

Finally, the proposed amendments would also correct an erroneous cross-reference in current Rule 2214 (Requirements for the Use of Investment Analysis Tools). The current rule mistakenly cross-references Rule 2210(c)(3)(D) instead of 2210(c)(3)(C).

For More Information

To discuss any topic covered here, please contact any member of the Investment Management Group or visit us at chapman.com.

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