

FINRA Proposes Amendments to Communications Rules, Including New Pre-Filing Requirements for Structured Products Communications

Contents

<i>Categories of Communications...</i>	1
<i>Approval, Review and Record-keeping of Communications.....</i>	2
<i>Filing and Review by FINRA.....</i>	3
New Members.....	3
Communications Concerning Certain Products.....	4
<i>Content Standards.....</i>	5
Recommendations.....	5
Public Appearances.....	6
Security Futures.....	6

On September 21, 2009, the Financial Industry Regulatory Authority (“**FINRA**”) proposed for public comment new rules governing member firms’ communications with customers and the public (the “**Proposed Rules**”).¹ The Proposed Rules would generally continue the substance of the current scheme, but would reorganize how various types of communications are classified. Of particular significance, the Proposed Rules would require retail communications regarding structured products to be filed with and reviewed by FINRA before they are used.

Categories of Communications

Currently, NASD Rules 2210 and 2211 and related Interpretive Materials as well as NYSE Rule 472 (the “**Existing Rules**”) assign different levels of principal approval, filing and content standards to communications based on whether the communication is categorized as an “advertisement,” “sales literature,” “correspondence,” “institutional sales material,” “public appearance” or “independently prepared reprint.” The Proposed Rules would eliminate certain distinctions between categories, such as generally combining “advertising” and “sales literature,” and reduce the number of categories. Under the Proposed Rules, there would be three categories of communications:

- *Institutional Communications*, which are communications only distributed or made available to institutional investors.² Institutional communications would generally include those communications currently classified as institutional sales material.
- *Retail Communications*, which are communications distributed or made available to more than 25 retail investors.³ Retail communications would generally include those communications currently classified as advertisements and sales literature.
- *Correspondence*, which are communications distributed or made available to 25 or fewer retail investors. This revised definition

¹ FINRA Regulatory Notice 09-55, *FINRA Requests Comments on Proposed New Rules Governing Communications with the Public*, available at <http://www.finra.org/Industry/Regulation/Notices/2009/P118711> (the “**Regulatory Notice**”). The Proposed Rules are part of FINRA’s rulebook consolidation process, which seeks to harmonize and consolidate the rules of the National Association of Securities Dealers, Inc. (“**NASD**”) and the New York Stock Exchange (“**NYSE**”).

² An “institutional investor” would include a bank, savings and loan association, insurance company, registered investment company, registered investment adviser or any other entity or natural person with total assets of at least \$50 million, as well as government entities, certain employee benefit plans and FINRA members.

³ A “retail investor” is anyone other than an institutional investor.

eliminates the Existing Rules' distinction between communications to existing or prospective customers.

The following chart compares the existing and proposed categories of communications:

Current Category	Currently Includes	Under Proposal
<i>Advertisement</i>	Communication with the public that appears in media, such as a newspaper, radio, television or website.	Would generally be considered retail communications.
<i>Sales literature</i>	Communication directed at a specific audience, such as mailers and brochures.	Would generally be considered retail communications.
<i>Institutional sales material</i>	Communication only distributed or made available to institutional investors.	Would generally be considered institutional communications.
<i>Correspondence</i>	Written communication for delivery to one or more current retail customers and less than 25 prospective retail customers within a 30-day period.	May be either correspondence or retail communications. New correspondence category would not distinguish between existing or prospective customers and would be limited to communications distributed or made available to 25 or fewer retail investors.
<i>Public appearance</i>	Participation in a seminar, radio or television interview or other public speaking.	Category is eliminated, but the type of communication would remain subject to content standards.
<i>Independently prepared reprint</i>	Reprint of an article issued by a publisher that is not affiliated with, and the article was not commissioned by, any of the FINRA member, the issuer, or an underwriter of securities mentioned in the article.	Category is eliminated, but this type of material would remain excluded from filing requirements.

Approval, Review and Recordkeeping of Communications

The Existing Rules require various levels of approval, review and recordkeeping procedures for each category of correspondence. The Proposed Rules would generally continue the existing review and approval requirements, as modified for the new categories, while adding an

exemption from review and approval for “solely administrative” retail communications.

Currently, advertisements, sales literature and independently prepared reprints must be approved by a registered principal of the firm before filing or first use. The proposal would revise the rule’s applicability to retail communications and change the approval requirement to an “appropriately qualified”⁴ registered principal. Current exceptions, such as for communications that are materially the same as those previously filed by another member, would remain unchanged. The Proposed Rules maintain the supervision and review structure for correspondence and institutional communications as under the Existing Rules.

The Proposed Rules would also add an explicit requirement that firms keep records of retail and institutional communications in the form and for the time periods prescribed by Rule 17a-4 under the Securities Exchange Act of 1934. Records of retail and institutional communications must include:

- a copy of the communication and the dates of first and last use;
- the name of the person who prepared or distributed institutional communications;
- the name of any registered principal who approved the communication and the date of approval;
- the source of statistical tables, charts, graphs or other illustrations; and
- if exempt from filing, records supporting the exemption.

Records of correspondence would continue to be governed by NASD Rules 3010(d) and 3110(a).⁵

Filing and Review by FINRA

The Existing Rules require certain types of advertisements and sales literature, and all advertisements by certain new FINRA members, to be filed with FINRA’s Advertising Regulation Department. In most cases, the Existing Rules require the filing to be made ten days before first use.

New Members

Currently, subject to various exceptions, FINRA members that have not previously filed advertisements with FINRA must file all advertisements at least ten business days before first use and continue to do so for one year. The Proposed Rules would expand the requirement to apply to all retail communications. Further, the one-year period would be revised to begin on the effective date of the FINRA member’s registration, rather than on the date of first filing.

⁴ The Proposed Rules do not define “appropriately qualified.”

⁵ Among other things, these rules require the development of appropriate written procedures for the review of correspondence and the retention of correspondence.

Communications Concerning Certain Products

The Existing Rules require all FINRA members to pre-file⁶ all advertisements concerning government securities, collateralized mortgage obligations, security futures and advertisements or sales material relating to registered investment companies that include performance rankings or comparisons that were not independently created.⁷ The proposal would require that any retail communication regarding these products be filed, instead of only advertisements.

Firms are also currently required to file within ten business days of first use any advertisements and sales literature concerning continuously offered closed-end investment funds or concerning any closed-end fund distributed during the fund's initial public offering. The proposal would expand this requirement to any retail communications regarding closed-end funds at any point, regardless of whether the fund is continuously offered or in its IPO period.

In what may be the most controversial aspect of the Proposed Rules, the proposal would expand the universe of communications that require pre-filing. The Proposed Rules would mandate pre-filing of retail communications concerning any "publicly offered securities derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance or a foreign currency."⁸ According to the Regulatory Notice, the purpose of this provision is to require the filing of retail communications regarding structured products.⁹

The proposal would "require firms for the first time to file prior to use retail communications concerning any publicly offered securities derived or based on a single security, a basket of securities, an index, a commodity, a debt issuance or a foreign currency."

Existing exceptions from the filing requirements would continue to apply under the proposal, including: (i) retail communications that have previously been filed and will be used without material change; (ii) retail communications that are "solely administrative in nature;" (iii) retail communications that only contain certain limited factual information; (iv) prospectuses, fund profiles, offering circulars or similar documents that have been filed with the Securities and Exchange Commission ("**SEC**") or any state, or that is "exempt from such registration;" and (v)

⁶ This pre-filing requirement also requires that the member withhold from publishing or circulating the communication until changes specified by FINRA have been made.

⁷ Certain communications concerning standardized options must also be filed prior to use under other rules. See NASD Rule 2220(c).

⁸ See FINRA Proposed Rule 2210(c)(2)(B).

⁹ Note, however, that pursuant to an August 2006 interpretive letter, the NASD confirmed that free writing prospectuses are excluded from the pre-use filing requirements of the Existing Rules. See Letter from Lisa C. Horrigan, Associate General Counsel, NASD, to Eileen Ryan, Securities Industry Association and Sarah Starkweather, Bond Market Association, dated August 1, 2006, available at <http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P017285>.

correspondence, institutional communications and independently prepared reprints (as currently defined). However, the existing exclusion for press releases “that are made available only to members of the media” would be removed, as FINRA believes this exclusion is no longer relevant because firms typically post press releases on their websites.

The Proposed Rules would add an exception for retail communications that are based on templates that were previously filed and are being updated only with more recent statistics or non-narrative information.

Content Standards

The Proposed Rules would reorganize, but generally continue the substance of, the existing content standards, while codifying certain existing interpretations. The Existing Rules require honest and balanced disclosure, with all material facts being presented in a non-misleading manner appropriate for the intended audience. Promissory statements, exaggerations and predictions are prohibited. The current and Proposed Rules also require various disclosures in communications that include comparisons, tax considerations, testimonials or recommendations.

Recommendations

The Proposed Rules would revise the content standards for communications containing a recommendation. The Existing Rules require that advertisements and sales literature that contain a recommendation of securities contain certain conflict of interest disclosures, provide or make available the basis for the recommendation and restrict references to past recommendations. Proposed revisions include:

- *Scope.* Applying the recommendation requirements to retail communications, correspondence and those communications that are currently classified as public appearances. Currently, these only apply to advertisements and sales literature.
- *Conflicts Disclosure.* Narrowing the group of parties whose financial interests in the recommended securities must be disclosed. Instead of requiring disclosure of any financial interests of the firm and its officers and partners, disclosure would be limited to the firm and “any associated person with the ability to influence the substance of the communication” containing the recommendation.
- *Prior Recommendations.* Revising the Existing Rules regarding communication of past recommendations to mirror the standards applicable to investment advisers under Rule 204(4)-1(a)(2) under the Investment Advisers Act of 1940.
- *Exclusions.* Adding two exclusions from the recommendation provisions:
 - (i) communications that recommend only registered investment companies or variable insurance products; or
 - (ii) communications that are considered “research reports” and comply with FINRA’s requirements for such reports.

Public Appearances

While the Proposed Rules would eliminate the existing “public appearance” communication category (which covers, for example, unscripted television interviews), the proposal specifies that if a public appearance does not fit into the new categories, it would still be subject to the general content standards and, if a recommendation is made, to the rules governing recommendations. Any written or electronic materials used in connection with a public appearance will be subject to the communication rules for the applicable communication category. The Proposed Rules would require members to adopt appropriate written policies, with specified minimum requirements, to supervise public appearances.

Security Futures

The Existing Rules require advertising regarding security futures products to contain certain disclosures and follow certain guidelines. Among other changes, the Proposed Rules would expand the applicability of the guidelines to all retail communications, revise certain content standards specific to security futures communications and require new disclosures.



FINRA has requested comments on the proposal by November 20, 2009. Interested persons may wish to consider the proposal and how any increased administrative burdens or necessary changes to compliance programs balance against any related benefits. Interested persons may also wish to consider the workability of any of the proposed new pre-filing requirements pertaining to structured products and whether the new requirements, if adopted, would necessitate any changes to current business practices.

The Proposed Rules will not become effective until filed with and approved by the SEC following a second comment period.

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