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Submitted via email to: rule-comments@sec.gov

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Notice of Proposed Rule Change to Amend FINRA Rule 2210 (Communications with the Public) to Permit Projections of Performance in Institutional Communications and Specified Communications to Qualified Purchasers (File No. SR-FINRA-2023-016) (the "Release")

Dear Ms. Countryman:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") in response to the request for comments by the Securities and Exchange Commission (the "SEC") with respect to its proposal to amend FINRA Rule 2210 to allow the use of projections and targeted returns in "institutional communications" as defined in FINRA Rule 2210 and in communications distributed solely to qualified purchasers ("QPs") as defined in the Investment Company Act of 1940 (the "1940 Act"), in each case, subject to certain conditions (the "Proposed Amendment").

This letter was prepared by members of the Committee's Trading and Markets Subcommittee. The comments expressed in this letter represent the views of the Committee only. They have not been reviewed or approved by the ABA's House of Delegates or Board of Governors and, accordingly, should not be construed as representing the position of the ABA. In addition, this letter does not represent the official position of the Section, nor does it necessarily reflect the views of all members of the Committee.

The Committee generally welcomes the Proposed Amendment as a needed modification to FINRA Rule 2210 for the reasons described below. At the same time, as further set forth below, the Committee believes that the Proposed Amendment will benefit from certain revisions and clarifications.

I. The Current Rule Unduly Restricts Broker-Dealers

As FINRA acknowledges in the Release, sophisticated investors that have access to independent advisers and resources often request to see projected performance metrics and targeted returns in connection with investment opportunities and use this information as an important input in their investment decisions, to, among other things, appropriately allocate portfolio risk.[1] Registered investment advisers have historically been permitted to include such metrics in the marketing materials for their funds pursuant to the SEC's guidance under the Investment Advisers Act of 1940 (the "Advisers Act") and this permission was further formalized in the provisions regarding "hypothetical performance" in Rule 206(4)-1 under the Advisers Act (the "New Marketing Rule") which was adopted by the SEC in December 2020.[2] The New Marketing Rule imposes certain specific relevance and disclosure requirements on registered investment advisers with respect to the use of such metrics.[3]

The general prohibition imposed by FINRA Rule 2210 on broker-dealers' communications including projections currently restricts broker-dealers from being able to provide projections, including targeted return metrics, to investors, without regard to whether they are retail or institutional, and thus, as acknowledged by FINRA in the Release, creates a disincentive for issuers (including fund sponsors, which are permitted to use such metrics under the New Marketing Rule) to utilize broker-dealers when marketing private offerings to sophisticated investors.[4] Rather than utilize broker-dealers as private placement agents, such issuers are motivated to have their employees market to such investors independently without the involvement of a broker-dealer pursuant to an exemption from broker-dealer registration such as the "issuer exemption" in Rule 3a4-1 under the Securities Exchange Act of 1934 ("Rule 3a4-1").[5] This arguably results in a negative economic impact on the broker-dealers serving as private placement agents and restricts market efficiencies and additional investor protections that would result from broker-dealers being more widely utilized as private placement agents.

Because Rule 3a4-1 is unavailable to issuers that have broker-dealer affiliates, FINRA Rule 2210 can be broadly interpreted to prohibit such issuers from conveying projections and targeted returns to investors in their marketing materials, which would otherwise be permitted under the Advisers Act. [6] Investment advisers that utilize third-party broker-dealers to market their securities are often forced to create two separate sets of marketing materials to accommodate investor requests, one for direct presentations by the investment adviser, and one for presentations by

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1 As stated by FINRA, such investors "often test their own opinions against performance projections they receive from other sources, including issuers and investment advisers". Release at 7-8.

2 Advisers Act Rule 206(4)-1(d)(6).

3 *Id.*

4 Release at 27.

5 *See* Release at 26-27; 33-34.

6 The definition of "associated person of a broker-dealer" under Rule 3a4-1 captures persons "under common control" with a broker-dealer.

the broker-dealer, though they are marketing to the same pool of investors. This, in turn, adds cost and complexity and introduces the possibility of inadvertent violations without any evident protection benefit to the sophisticated investors that receive such marketing materials. The Proposed Amendment is a welcome exception that will not only introduce more consistency to a regulatory landscape that has been unbalanced, especially as it relates to the marketing of private funds, but also improve information flow with financially sophisticated investors.

II. The Proposed Eligibility Threshold

The Committee believes that the Proposed Amendment would establish a reasonable threshold by which investors will be eligible to receive projections and targeted returns, by allowing broker-dealers to include such metrics in institutional communications, as defined under FINRA Rule 2210, as well as communications to QPs, as defined under the 1940 Act, with respect to offerings in which only QPs can invest (*e.g.,* offerings of funds that are exempt from registration pursuant to Section 3(c)(7) of the 1940 Act (a "3(c)(7) Fund")). Institutional investors, per the "institutional account" definition under FINRA Rule 4512(c), and QPs can reasonably be expected to have the requisite sophistication and resources available to them to independently assess and utilize projections and targeted returns provided by broker-dealers to inform their investment decisions. Moreover, setting the eligibility threshold at QPs and above is consistent with the fact that, as FINRA acknowledges in the Release, capital acquisition brokers ("CABs") are presently permitted to distribute communications that include projections to QPs.[7]

While the Committee believes that the eligibility threshold set by the Proposed Amendment is reasonable, the Committee believes that it would further reduce the burden on broker-dealers and fund managers to broaden the eligibility to also include communications to QPs in connection with offerings that are not limited exclusively to QPs. We note that the CAB rules permit the sending of projections to QPs generally, regardless of who else participates in the offering. Further, as noted above, the Committee believes that QPs can generally be expected to have the requisite degree of sophistication and resources available to them to benefit, rather than be susceptible to harm, from receiving targeted returns and projections. The Committee believes that this is the case regardless of whether the relevant broker-dealer communication is in relation to an offering in which only QPs can invest (e.g., a 3(c)(7) Fund offering) or an offering in which non-QPs can also invest (e.g., a fund offering that is exempt from registration pursuant to Section 3(c)(1) of the 1940 Act or a registered offering).

[7] As noted by FINRA, CAB Rule 016(i) defines "institutional investor" to included QPs. Release at 43.

III. The Additional Relevance Requirement is Ambiguous and Unnecessary

The Proposed Amendment would impose an additional requirement that a broker-dealer adopt and implement "policies and procedures reasonably designed to ensure that the communication is relevant to the likely financial situation and investment objectives of the investor receiving the communication and to ensure compliance with all applicable requirements and obligations."[8] While appreciating that this provision parallels the corresponding requirement under the New Marketing Rule of adopting and implementing reasonably designed policies and procedures to ensure that hypothetical performance is "relevant to the likely financial situation and investment objectives of the intended audience of the advertisement," the Committee does not believe this provision is necessary for the Proposed Amendment, since broker-dealers will already be responsible for having reasonably designed policies and procedures to ensure that the recipients are either QPs or institutional investors. This type of a provision makes sense to the Committee as a broad principle-based requirement under the New Marketing Rule, which unlike the Proposed Amendment, does not otherwise set a minimum eligibility requirement; however, it is unclear to the Committee what additional due diligence or inquiry would practically be required on the part of a broker-dealer under the Proposed Amendment beyond making the determination that the recipient is a QP or institutional investor. As noted by FINRA in the Release, natural persons who are QPs or institutional investors and thus eligible to receive broker-dealer communications with projections and targeted returns would separately be protected by Regulation Best Interest to the extent that a broker-dealer is deemed to be making a recommendation to them.[9] The Committee also believes that not including such a requirement would generally be consistent with the lighter customer-specific suitability obligation placed on broker-dealers with respect to institutional accounts under FINRA Rule 2111(b). Based on the foregoing, the Committee believes that the requirement is duplicative, unfounded, and unduly burdensome, and consequently should not be imposed on broker-dealers.

If, however, this element of the Proposed Amendment is nevertheless adopted, the Committee respectfully requests the issuance of guidance that explains what broker-dealers acting as placement agents should do in circumstances where they determine that projections or targeted returns are appropriate for some potential investors in the prescribed nonpublic offerings, but not others, including whether broker-dealers should limit the use of projection and targeted return information to

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8 Rule 2210(d)(1)(F)(iv)(b) in the Proposed Amendment. Release at 227.

9 Release at 8.

prospective fund investors who pass the independent suitability requirements of FINRA Rule 2111 and Regulation Best Interest.[10]

IV. Additional Clarity Regarding Historical IRR Would Be Beneficial

There is no specific discussion in the Release regarding how the Proposed Amendment will be applicable to historical internal rates of return ("IRR"). FINRA has stated in its prior guidance that, unless fully realized, historical IRR that is included in a retail communication should be calculated in compliance with Global Investment Performance Standards ("GIPS") in order to comply with FINRA Rule 2210.[11] Like projections and targeted returns, sophisticated investors often desire to see historical IRR metrics in connection with potential investment opportunities and oftentimes it can be exceedingly difficult and expensive for issuers to generate such metrics in a manner that is compliant with GIPS. Even in the case of issuers whose accounting practices currently comply with GIPS, it can be impractical to comply with GIPS when reporting historical performance from a time period prior to the issuer's adoption of GIPS.

The SEC does not impose a GIPS compliance requirement with respect to such metrics on investment advisers through the New Marketing Rule or otherwise. Accordingly, this requirement constitutes another way in which broker-dealers are subject to greater restrictions than investment advisers when marketing investments to QPs. The Proposed Amendment would allow for the use of projections and targeted returns in retail communications to QPs with respect to QP-only investments. The Committee assumes that this allowance with respect to retail communications to QPs would also extend to the use of non-GIPS compliant historical IRR with unrealized components, however, the Committee believes that it would be helpful for FINRA to clarify this explicitly in either the Proposed Amendment or the guidance in relation thereto.

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[10] FINRA declined to permit the selective use of prior related performance in marketing materials for a private fund offering in communications to "qualified institutional buyers" ("QIBs"), as defined in Rule 144A(a)(1) under the Securities Act of 1933, based, among other things, on the grounds that this would result in disparate treatment of non-QIB investors in the private fund. *See* FINRA Interpretive Letter to Budge Collins, Collins Bay/Island Securities, Sept. 14, 2004. ("By restricting the dissemination of such information to QIBs, there is the possibility that those potential investors who qualify as QIBs will be treated differently than other potential investors and will have access to information that is not available to others.")

[11] FINRA Regulatory Notice 20-21; *see also* FINRA Frequently Asked Questions About Advertising Regulation D.6.

We greatly appreciate the opportunity to provide comments with respect to this important rule-making effort and thank the SEC staff for its efforts and thoughtful approach to the issues addressed by Proposed Amendment. Members of the Committee are available to meet and discuss these matters with the SEC and FINRA staff and to respond to any questions.

Very truly yours,

/s/ Jay H. Knight

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