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April 12, 2024

Sherry Haywood, Assistant Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Via online submission

Re: File No. SR-FINRA-2023-016[1]

Dear Ms. Haywood,

The Center for American Progress (CAP) appreciates the opportunity to object to the above proposal, as modified by Amendment 1, to amend Financial Industry Regulatory Authority (FINRA) Rule 2210.

CAP is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, strong leadership, and concerted action.

As more fully articulated below, the Proposal is inconsistent with the Securities Exchange Act and Commission Rules, and the Commission should disapprove it.

Standard of Review

The Commission may approve FINRA's rules only if they meet specified criteria, including that:

[1] Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 2210 (Communications with the Public) to Permit Projections of Performance of Investment Strategies or Single Securities in Institutional Communications, SEC, Exch. Act Rel. No. 34-98977, Nov. 17, 2023, available at https://www.sec.gov/files/rules/sro/finra/2023/34-98977.pdf ("Initial Proposal"); Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as modified by Amendment No. 1, to Amend FINRA Rule 2210 (Communications with the Public) to Permit Projections of Performance of Investment Strategies or Single Securities in Institutional Communications, SEC, Exch. Act Rel. No. 34-99588, Feb. 22, 2024, available at https://www.sec.gov/files/rules/sro/finra/2024/34-99588.pdf ("Amended Proposal").

- They “are designed to prevent fraudulent and manipulative acts and practices;”[2]
- They “are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers;”[3]
- They provide for the “equitable allocation of reasonable dues, fees, and other charges;”[4]
- They do “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter;”[5] and
- They are designed “to protect investors and the public interest.”[6]

The Securities Exchange Act requires the Commission to "find" or "determine” that FINRA rules meet those requirements after it “examine[s] the relevant data and articulate[s] a satisfactory explanation for its action including a ‘rational connection between the facts found and the choice made.”[7]

The Commission’s Rules of Practice clearly establish that the “burden to demonstrate that a proposed rule change is consistent with the [Exchange Act] and the rules and regulations issued thereunder . . . is on the self-regulatory organization that proposed the rule change” and that a “mere assertion that the proposed rule change is consistent with those requirements . . . is not sufficient.”[8] A self-regulatory organization (SRO) such as FINRA must provide a “description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding.”[9]

Further, the Court of Appeals for the DC Circuit has ruled that “unquestioning reliance” on an SRO's representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.[10]

FINRA’s Unprecedented Proposal

For decades, the National Association of Securities Dealers, and later its successor, the Financial Industry Regulatory Authority (FINRA), have maintained and enforced

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[2] 15 U.S. Code § 78o–3(b)(6), available at https://www.law.cornell.edu/uscode/text/15/78o-3.
[3] Ibid.
[4] 15 U.S. Code § 78o–3(b)(5), available at https://www.law.cornell.edu/uscode/text/15/78o-3.
[5] 15 U.S. Code § 78o–3(b)(9), available at https://www.law.cornell.edu/uscode/text/15/78o-3.
[6] 15 U.S. Code § 78o–3(b)(6), available at https://www.law.cornell.edu/uscode/text/15/78o-3.
[7] See *Susquehanna Int’l Grp., LLP v. SEC*, 866 F.3d 442, 447 (D.C. Cir. 2017) (citing *Motor Vehicle Mfrs.Ass’n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. U.S.*, 371 U.S. 156, 168 (1962)))(reviewing the standard applicable to the Commission’s review of a filing by another SRO, the Options Clearing Corporation), available at https://casetext.com/case/susquehanna-intl-grp-llp-v-sec-exch-commn.
[8] 17 CFR § 201.700(b)(3)(i), available at https://www.law.cornell.edu/cfr/text/17/201.700.
[9] Ibid.
[10] *Susquehanna Int'l Grp., LLP v. SEC*, 866 F.3d 442, 447 (D.C. Cir. 2017).

detailed rules regarding broker-dealers' communications with the public, including actual and potential investors. These SRO-imposed obligations on brokers are intended to protect investors from potentially misleading information.

Today, FINRA Rule 2210 (the "Communications with the Public rule") provides both procedural and substantive protections. Specifically, it requires communications to be reviewed by appropriate supervisory personnel prior to use, the retention of communications, and much more.[11] Rule 2210 also prohibits brokers from predicting or projecting investment performance, or implying that past performance will recur, or making "any exaggerated or unwarranted claim, opinion or forecast."[12]

For publicly-traded securities, such as equities or mutual fund interests, the Commission has detailed rules for disclosures related to performance and potential projections. However, no such protections currently exist for so-called private market securities. While the Commission has some very limited protections on marketing practices by registered investment advisers,[13] in general, for securities that are exempt from registration, FINRA's Communications with the Public rule effectively provides the only meaningful protection to investors.

On November 13, 2023, in a short release lacking sufficient substantive legal or economic analysis, FINRA proposed to effectively abandon its decades-long protection against misleading performance predictions and projections.[14]

In articulating the alleged "need" to effectively abandon this protection, FINRA asserts that

> FINRA understands that some broker-dealer customers, in particular institutional investors, request other types of projected performance that the current rules do not allow … [and that] projected performance may be useful for institutional investors and QPs [Qualified Purchasers] that either have the financial expertise to evaluate investments and to understand the assumptions and limitations associated with such projections, or that have resources that provide them with access to financial professionals who possess this expertise. Such investors often test their own opinions against performance projections they receive from other sources, including issuers and investment advisers. Because Rule 2210 generally precludes a member from providing projected performance or targeted returns in marketing communications

[11] FINRA, Rule 2210. Communications with the Public, available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/2210 (last accessed April 2024).
[12] Initial Proposal, at 2; and FINRA Rule 2210(d)(1)(F).
[13] 17 CFR § 275.206(4)-1, available at https://www.ecfr.gov/current/title-17/chapter-II/part-275/section-275.206(4)-1.
[14] Initial Proposal.

distributed to institutional investors and QPs, these investors cannot obtain a member's potentially different and valuable perspective.[15]

The Proposal purportedly seeks to add "investor protections" that effectively boil down to requiring a firm that makes predictions or projections to

- Adopt and implement "written policies and procedures" on how it makes the predictions;
- Have a "reasonable basis" to support its process for making the predictions;
- "[P]rominently" disclose that "the projected performance or targeted return is hypothetical in nature and that there is no guarantee that the projected or targeted performance will be achieved;" and
- Provide investors with some basic information on the risks of the projection. [16]

In its filing, FINRA inaccurately narrows the purported value of Rule 2210, asserting that "the general prohibition against performance projections is intended to protect investors who may lack the capacity to understand the risks and limitations of using projected performance in making investment decisions."[17]

But for decades the rule has applied to purportedly sophisticated and unsophisticated investors alike and for good reason: Investors of any level of sophistication may be misled by cherry-picked or inaccurate information and dubious projections or predictions.

It is not surprising that FINRA's unprecedented proposal has been welcomed by many trade associations for brokers and investment advisers who seek to advertise their complex and unregistered private markets investment products as widely as possible. In fact, one trade association for private funds argued in its comments that this already unprecedented loophole should be expanded to include communications to retail investors.[18]

This would be extremely harmful to retail and sophisticated investors alike.

Today, nearly every investor in the U.S. is exposed either directly or indirectly to private market risks, and more capital is raised annually in these markets than in the public markets. This is largely due to the proliferation of exemptions from the public

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[15] Initial Proposal, at 4-5.
[16] Initial Proposal, at 7-8.
[17] Initial Proposal, at 2.
[18] Letter from Dorothy M. Donohue and Matthew Thornton, Investment Company Institute, to Sherry Haywood, SEC, Dec. 15, 2023, available at https://www.sec.gov/comments/sr-finra-2023-016/srfinra2023016-314280-819322.pdf ("We recommend that FINRA likewise broaden the reach of any final rule amendments to include retail investors….").

company registration and disclosure framework.[19] Today the number of private companies valued at more than $1 billion has skyrocketed to more than 600.[20] This growth in private markets is driving private companies and funds to target retail investors and seek capital from pensions and retirement plans that are the lifeline for millions of American workers who strive to save enough from their earnings to sustain themselves in retirement.

Without audited financial statements and basic information about operations, management, and risks, investors and other market participants do not have the information they need to determine the value of these unregistered and often complex private securities. And, while many exemptions are only permitted for offerings to so-called "accredited investors," even the most sophisticated investor cannot value securities without reliable, consistent, and comparable information about these fundamentals.

Without being subject to this disclosure framework, private companies and funds face few repercussions for pumping up valuations, imposing unjustified or hidden fees, or exaggerating performance. Removing advertising and other communications protections related to performance projections for private securities would only increase the risks of private market investing.

The proposed FINRA Rule 2210 loophole would further expose investors either directly or indirectly through their investment managers to some of the greatest risks in the private markets: inaccurate, unsupported, and often grossly inflated valuations; excessive, inappropriate, or hidden fees, which are not incorporated into assessments of returns; and inflated or inaccurate performance claims and metrics.

Worse, given the frequently bespoke nature of investment performance due to often-customized fees and other investment treatment, it would be extremely difficult, if not impossible, to offer predictions or projections that are not materially misleading in these products. How, for example, could a private equity fund that has 25 different investors, each with its own different set of preferences and fee arrangements extrapolate and project its returns for future investors? What elements are required to be the same, versus different? And how will that information be assessed and understood by different categories of investors, who will likely have different terms of investment?

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[19] See, Tyler Gellasch, Alexandra Thornton, and Crystal Weise, "How Exemptions From Securities Laws Put Investors and the Economy at Risk," Center for American Progress, March 22, 2023, available at https://www.americanprogress.org/article/how-exemptions-from-securities-laws-put-investors-and-the-economy-at-risk/.

[20] CB Insights, "The Complete List of Unicorn Companies," available at https://www.cbinsights.com/research-unicorn-companies (last accessed March 2024; data as of March 2024).

Further, a private securities issuer's major investors may each assess the securities at different values,[21] or the issuer's management may unilaterally change its assessment of the securities' value without explanation, with limited ability for other market participants to assess the basis for the change.[22] And valuations for private securities are often slow to reflect market downturns.[23] How could those be reflected in projections without being materially misleading?

Approval of the FINRA proposal would ignore the facts and logic the Commission set forth in support of its recently finalized Private Fund Advisers rule[24] and would contravene that rule's express purpose. While that final rule was insufficient in establishing standardized valuation practices in private offerings, it took important steps toward that goal by requiring private funds and their advisers to provide investors with regular account statements, standardized fee and expense information, and basic disclosures regarding their conflicts of interest, in addition to requiring private funds to have annual audits. The Commission has recognized the need for such standardization on many occasions.[25]

Finally, FINRA's Initial Proposal and cursory Amended Proposal are materially deficient. They fail to thoroughly identify the securities that would be covered or explain with any specificity how the new exemption would operate, let alone offer any substantive analysis of any of these details. Given these shortcomings, the Proposal's purported "investor protections" are facially insufficient to provide investors with an accurate picture of the securities and would instead enable the widespread misleading of investors in these already perilous markets.

In sum, the Proposal is contrary to the protection of investors and the public interest and should be disapproved on that basis. Furthermore, as described above, FINRA has

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[21] David W. McCombie III, "Coming Clean On Valuations," *Forbes,* January 5, 2023, available at https://www.forbes.com/sites/davidwmccombie/2023/01/05/coming-clean-on-valuations/?sh=4a08e26559a1.

[22] Jackie Davalos and Emily Chang, "Instacart Slashes Its Valuation by Almost 40% to $24 Billion," Bloomberg, March 24, 2022, available at https://www.bloomberg.com/news/articles/2022-03-25/instacart-slashes-its-valuation-by-almost-40-to-24-billion.

[23] Cliff Asness, "Why Does Private Equity Get to Play Make-Believe With Prices?", Institutional Investor, January 6, 2023, available at https://www.institutionalinvestor.com/article/2bstqfcskz9o72ospzlds/opinion/why-does-private-equity-get-to-play-make-believe-with-prices.

[24] Securities and Exchange Commission, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews," 88 Fed. Reg. 63206 et seq., available at https://www.federalregister.gov/documents/2023/09/14/2023-18660/private-fund-advisers-documentation-of-registered-investment-adviser-compliance-reviews.

[25] See, e.g., Office of Compliance Inspections and Examinations (OCIE), "Observations from Examinations of Private Fund Advisers," U.S. Securities and Exchange Commission, June 27, 2022, available at https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf; and OCIE, "Observations from Examinations of Investment Advisers Managing Private Funds, U.S. Securities and Exchange Commission, June 23, 2020, available at https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf.

failed to provide the Commission with sufficient information to ensure that the filings meet their burdens under the Securities Exchange Act, and thus should be disapproved on that basis as well.

For any questions regarding this comment letter, please contact Alexandra Thornton, Senior Director, Financial Regulation, at the Center for American Progress, athornton@americanprogress.org.

Sincerely,

Center for American Progress