SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-99588; File No. SR-FINRA-2023-016)

February 22, 2024

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; 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

I. Introduction

On November 13, 2023, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change (SR-FINRA-2023-016) to amend FINRA Rule 2210 (Communications with the Public).[3] The proposed rule change would allow a member firm to project the performance[4] of, or provide a targeted return[5] with respect to, a security or asset allocation or other investment strategy in an institutional communication[6] or a communication

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.

[3] See Exchange Act Release No. 98977 (Nov. 17, 2023), 88 FR 82482 (Nov. 24, 2023) (File No. SR-FINRA-2023-016) ("Notice"), https://www.govinfo.gov/content/pkg/FR-2023-11-24/pdf/2023-25881.pdf.

[4] FINRA stated that "projections of performance reflect an estimate of the future performance of an investment or investment strategy, which is often based on historical data and assumptions." Notice at 82482 n.3 (citing *Investment Adviser Marketing*, Investment Advisers Act Release No. 5653 (Dec. 22, 2020), 86 FR 13024, 13081 n.699 (Mar. 5, 2021) and accompanying text).

[5] FINRA stated that "targeted returns reflect the aspirational performance goals for an investment or investment strategy." Notice at 82482 n.3 (citing *Investment Adviser Marketing,* Investment Advisers Act Release No. 5653 (Dec. 22, 2020), 86 FR 13024, 13081 n.699 (Mar. 5, 2021) and accompanying text).

[6] An "institutional communication" means "any written (including electronic) communication that is distributed or made available only to institutional investors, but does not include a member's internal communications." Rule 2210(a)(3). An "institutional investor" means any: "(A) person described in Rule 4512(c), regardless of whether the person has an account with a member; (B) governmental entity or subdivision thereof; (C) employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans;

distributed solely to qualified purchasers ("QPs") as defined in the Investment Company Act of 1940 ("Investment Company Act")[7] that promotes or recommends specified non-public offerings, subject to conditions to help ensure these projections are carefully derived from a sound basis.[8]

The proposed rule change was published for public comment in the Federal Register on November 24, 2023.[9] The public comment period closed on December 15, 2023. The Commission received comment letters in response to the Notice.[10] On January 5, 2024, FINRA consented to an extension of the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine

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(D) qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans; (E) member or registered person of such a member; and (F) person acting solely on behalf of any such institutional investor." FINRA Rule 2210(a)(4). FINRA Rule 4512(c) states that for purposes of Rule 4512 (Customer Account Information), the term "institutional account" means: a bank, savings and loan association, insurance company or registered investment company; an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission; or any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

[7] Section 2(a)(51)(A) of the Investment Company Act (15 U.S.C. 80a-2(a)(51)(A)) defines the term "qualified purchaser" as "(i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 80a–3(c)(7) of [the Investment Company Act] with that person's qualified purchaser spouse) who owns not less than $5,000,000 in investments, as defined by the Commission; (ii) any company that owns not less than $5,000,000 in investments and that is owned directly or indirectly by or for 2 or more natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons; (iii) any trust that is not covered by clause (ii) and that was not formed for the specific purpose of acquiring the securities offered, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a person described in clause (i), (ii), or (iv); or (iv) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25,000,000 in investments." 15 U.S.C. 80a-2(a)(51)(A).

[8] See Notice.

[9] Id.

[10] The comment letters are available at https://www.sec.gov/comments/sr-finra-2023-016/srfinra2023016.htm.

whether to approve or disapprove the proposed rule change to February 22, 2024.[11] On February 22, 2024, FINRA responded to the comment letters received in response to the Notice and filed an amendment to modify the proposed rule change ("Amendment No. 1").[12]

The Commission is publishing this order pursuant to Section 19(b)(2)(B) of the Exchange Act[13] to solicit comments on the proposed rule change, as modified by Amendment No. 1, and to institute proceedings to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1 (hereinafter referred to as the "proposed rule change" unless otherwise specified).

II. Description of the Proposed Rule Change, as Modified by Amendment No. 1

A. Background

1. FINRA Rule 2210 (Communications with the Public)

FINRA Rule 2210 imposes obligations related to, among other things, the approval, review, recordkeeping, filing, and content of member firm communications with the public.[14] Specifically, Rule 2210(d)(1) imposes six general standards for the content of a member firm's communications with the public.[15] Among these six standards is a general prohibition on predicting or projecting performance, implying that past performance will recur, or making any exaggerated or unwarranted claim, opinion, or forecast.[16] However, this general prohibition does

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[11] See letter from Meredith Cordisco, Associate General Counsel, Office of General Counsel, FINRA, to Craig Slivka, Division of Trading and Markets, Commission, dated January 5, 2024, https://www.finra.org/sites/default/files/2024-01/SR-FINRA-2023-016-extension1.pdf.

[12] See letter from Meredith Cordisco, Associate General Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission, dated February 22, 2024, https://www.sec.gov/comments/sr-finra-2023-016/srfinra2023016.htm ("FINRA Response Letter"); see also Amendment No. 1https://www.sec.gov/comments/sr-finra-2023-016/srfinra2023016-433139-1075042.pdf.

[13] 15 U.S.C. 78s(b)(2)(B).

[14] See FINRA Rule 2210.

[15] FINRA Rule 2210(d)(1).

[16] FINRA Rule 2210(d)(1)(F).

not apply to three types of communications.[17] First, a member firm may provide "a hypothetical illustration of mathematical principles, provided that it does not predict or project the performance of an investment or investment strategy."[18] Second, a member firm may publish "[a]n investment analysis tool, or a written report produced by an investment analysis tool, that meets the requirements of FINRA Rule 2214 (Requirements for the Use of Investment Analysis Tools)."[19] Third, a member may communicate "[a] price target contained in a research report on debt or equity securities, provided that the price target has a reasonable basis, the report discloses the valuation methods used to determine the price target, and the price target is accompanied by disclosure concerning the risks that may impede achievement of the price target."[20] Unless one of these three exceptions applies, no member firm may communicate projected performance or targeted return information to the public.[21]

B. The Proposed Rule Change, as Modified by Amendment No. 1

The proposed rule change would create a fourth exception to the general prohibition on the communication of projected performance or targeted return information, subject to conditions designed to protect investors.[22] Each condition of the proposed rule change is discussed in turn.

1. Institutional and QP Private Placement Communications

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17 FINRA Rule 2210(d)(1)(F)(i)-(iii).

18 FINRA Rule 2210(d)(1)(F)(i).

19 FINRA Rule 2210(d)(1)(F)(ii). An "investment analysis tool" is "an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices." FINRA Rule 2214(b).

20 FINRA Rule 2210(d)(1)(F)(iii).

21 See FINRA Rule 2210(d)(1)(F).

22 Proposed Rule 2210(d)(1)(F)(iv); see Notice at 82483.

As originally proposed, the proposed rule change would permit the use of projected performance or targeted returns with respect to a security or asset allocation or other investment strategy only in (1) an institutional communication or (2) a communication that is distributed or made available only to QPs and that promotes or recommends either a "member private offering"[23] that is exempt from the requirements of Rule 5122 pursuant to Rule 5122(c)(1)(B),[24] or a private placement that is exempt from the requirements of Rule 5123 pursuant to Rule 5123(b)(1)(B).[25] Amendment No. 1 modified proposed Rule 2210(d)(1)(F)(iv)(a) to also permit member firms to include projections of performance and targeted returns in communications that are distributed or made available to persons meeting the definition of knowledgeable employee under Investment Company Act Rule 3c-5[26] and that promote or recommend a private placement that is exempt from the requirements of Rule 5123 pursuant to Rule 5123(b)(1)(H).

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23 A "member private offering" means "a private placement of unregistered securities issued by a member or a control entity." Rule 5122(a)(1).

24 FINRA Rule 5122 (Private Placements of Securities Issued by Members) governs, among other things, the disclosure and filing requirements applicable to members that participate in a private placement of unregistered securities issued by a member or a control entity ("member private offerings"). Rule 5122(c)(1)(B) states that member private offerings sold solely to qualified institutional buyers, as defined in Rule 144a of the Securities Act of 1933 ("Securities Act"), are exempt from the requirements of Rule 5122.

25 FINRA Rule 5123 (Private Placement of Securities) governs, among other things, the filing requirements applicable to members that sell a security in a non-public offering in reliance on an available exemption from registration under the Securities Act ("private placement"). Rule 5123(b)(1)(B) exempts from the requirements of this Rule 5213 offerings sold solely to qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act. See supra note 7.

26 For purposes of the proposed rule change, the term "knowledgeable employee" generally means any natural person who is an executive officer, director, trustee, general partner, advisory board member, or person serving in similar capacity of a private fund that relies on Investment Company Act section 3(c)(7) to avoid registration under the Investment Company Act or certain of its affiliates, and other employees, under certain conditions, who participate in the investment activities of the fund or certain of the fund's affiliates. See Investment Company Act Rule 3c-5 (17 CFR 270.3c-5(a)(4)). The "knowledgeable employee" definition in Rule 3c-5 also refers to specified officers, directors, and employees of private funds relying on section 3(c)(1) of the Investment Company Act. However, because Rules 5122 and 5123 do not exempt section 3(c)(1) funds that are sold to natural person accredited investors, a private offering sold to a knowledgeable employee of a 3(c)(1) fund generally would not be eligible for the exemptions from those rules. See FINRA Response Letter at note 30.

FINRA stated that the proposed rule change, as modified by Amendment No. 1, would limit the scope of the new exception to specified scenarios involving institutional investors, QPs, or knowledgeable employees who are more likely to understand the risks and limitations of projections or targeted returns.[27] Institutional investors, QPs, and knowledgeable employees as described above are referred to herein collectively as "Projection-Eligible Investors." [28]

2. Written Policies and Procedures

The proposed rule change would require any member firm that communicates projected performance or targeted returns to Projection-Eligible Investors to "adopt[] and implement[] written 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."[29] FINRA stated that "the mere fact that an investor would be interested in high returns" would not – standing alone – mean that the projected performance or targeted return information "is relevant to the likely financial situation and investment objectives."[30] FINRA also stated that each member firm should consider its "audience" because projected performance or targeted return information "should only be distributed where the member reasonably believes the investors have access to resources to independently analyze this information or have the financial expertise to understand the risk and limitations of such presentations."[31]

3. Reasonable Basis Requirement

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27 See Notice at 82483; see also FINRA Response Letter at 6.

28 Proposed Rule 2210(d)(1)(F)(iv)(a).

29 Proposed Rule 2210(d)(1)(F)(iv)(b).

30 Notice at 82484 n.22.

31 Id. at 82484.

The proposed rule change would require any member firm that communicates projected performance or targeted returns to Projection-Eligible Investors to have "a reasonable basis for the criteria used and assumptions made in calculating the projected performance or targeted return, and retain[] written records supporting the basis for such criteria and assumptions."[32] Because "FINRA believes that it is important for members to consider appropriate factors in forming a reasonable basis for the criteria used and assumptions made in calculating projected performance or targeted return,"[33] the proposed rule change would include a non-exhaustive list of factors that members should consider when meeting this obligation.[34] These factors include, but are not limited to: (1) global, regional, and country macroeconomic conditions; (2) documented fact-based assumptions concerning the future performance of capital markets; (3) in the case of a single security issued by an operating company, the issuing company's operating and financial history; (4) the industry's and sector's current market conditions and the state of the business cycle; (5) if available, reliable multi-factor financial models based on macroeconomic, fundamental, quantitative, or statistical inputs, taking into account the assumptions and potential limitations of such models, including the source and time horizon of data inputs; (6) the quality of the assets included in a securitization; (7) the appropriateness of selected peer-group comparisons; (8) the reliability of research sources; (9) the historical performance and performance volatility of the same or similar asset classes; (10) for managed accounts or funds, the past performance of other accounts or funds managed by the same investment adviser or sub-adviser, provided such accounts or funds had substantially similar investment objectives, policies, and strategies as the account or fund for which the projected

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32 Proposed Rule 2210(d)(1)(F)(iv)(c).

33 Notice at 82484.

34 See Proposed Supplementary Material 2210.01(a) (stating that no one factor is determinative).

performance or targeted returns are shown; (11) for fixed income investments and holdings, the average weighted duration and maturity; (12) the impact of fees, costs, and taxes; and (13) expected contribution and withdrawal rates by investors.[35] The proposed rule change also would prohibit members from basing projected performance or a targeted return upon (1) hypothetical, back-tested performance or (2) the prior performance of a portfolio or model that was created solely for the purpose of establishing a track record.[36]

4. Disclosure Requirements

The proposed rule change would impose three disclosure-related requirements. First, any communication of projected performance or targeted return information to a Projection-Eligible Investor must "prominently 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."[37]

Second, the proposed rule change would require any member firm communicating projected performance or targeted return information to a Projection-Eligible Investor to "provide[] sufficient information to enable the investor to understand . . . the criteria used and assumptions made in calculating the projected performance or targeted return, including whether the projected performance or targeted return is net of anticipated fees and expenses."[38] FINRA explained that this requirement "is not intended to prescribe any particular methodology or calculation of such performance," and it does not "expect a firm to disclose proprietary or

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35 Proposed Supplementary Material 2210.01(a).

36 Proposed Supplementary Material 2210.01(b).

37 Proposed Rule 2210(d)(1)(F)(iv)(d).

38 Proposed Rule 2210(d)(1)(F)(iv)(e).

confidential information regarding the firm's methodology and criteria."[39] But FINRA emphasized that firms "would be expected . . . to provide a general description of the methodology used sufficient to enable the investors to understand the basis of the methodology, as well the assumptions underlying the projection or targeted return."[40] Absent these required disclosures, FINRA explained, "it is more likely that a projection or targeted return would mislead a potential investor."[41]

Third, the proposed rule change would require any member firm communicating projected performance or targeted return information to a Projection-Eligible Investor to "provide[] sufficient information to enable the investor to understand . . . the risks and limitations of using the projected performance or targeted return in making investment decisions, including reasons why the projected performance or targeted return might differ from actual performance."[42] FINRA explained that this requirement "is intended to help ensure that such investors do not unreasonably rely on a projection or targeted return given its uncertainty and risks."[43]

III. Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2023-016 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to determine whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved.[44] Institution of proceedings is appropriate at this

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39 Notice at 82485.

40 Id.

41 Id.

42 Proposed Rule 2210(d)(1)(F)(iv)(e).

43 Notice at 82485.

44 15 U.S.C. 78s(b)(2)(B).

time in view of the legal and policy issues raised by the proposed rule change, as modified by Amendment No. 1. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change, as modified by Amendment No. 1.

Pursuant to Section 19(b)(2)(B) of the Exchange Act, the Commission is providing notice of the grounds for disapproval under consideration.[45] The Commission is instituting proceedings to allow for additional analysis and input concerning whether the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules thereunder.

IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposed rule change, as modified by Amendment No. 1. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.[46]

Interested persons are invited to submit written data, views, and arguments regarding

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[45] Id.

[46] Section 19(b)(2) of the Exchange Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved by [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [INSERT DATE 35 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's internet comment form (https://www.sec.gov/rules/sro.shtml); or
- Send an email to rule-comments@sec.gov. Please include file number SR-FINRA-2023-016 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to file number SR-FINRA-2023-016. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (https://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, as modified by Amendment No. 1, that are filed with the Commission, and all written communications relating to the proposed rule change, as modified by Amendment No. 1, between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington,

DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-FINRA-2023-016 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]. If comments are received, any rebuttal comments should be submitted on or before [INSERT DATE 35 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[47]

J. Matthew DeLesDernier,

Deputy Secretary.

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[47] 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).