

Advertising Regulation

FINRA Provides Guidance on Advertising Regulation Issues

Executive Summary

FINRA is providing guidance to firms on certain issues related to the application of NASD Rule 2210 and the filing of communications for review with FINRA's Advertising Regulation Department. FINRA intends to periodically issue guidance to the industry concerning significant interpretive issues or other issues related to FINRA rules governing communications with the public.

Questions concerning this *Notice* should be directed to:

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- ▶ Amy C. Sochard, Director, Advertising Regulation, at (240) 386-4508.

Background and Discussion

In order to inform firms of recent developments regarding the application of the rules governing communications with the public, FINRA is providing the following guidance to firms on selected communications with the public issues.

Exchange-Traded Products

NASD Rule 2210(c)(2)(A) requires a firm to file advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts, continuously offered closed-end funds and unit investment trusts) with FINRA within 10 business days of first use or publication. This filing requirement applies to any advertisement or sales literature concerning an exchange-traded fund that is registered under the Investment Company Act of 1940 (1940 Act ETF).

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Suggested Routing

- ▶ Advertising
- ▶ Compliance
- ▶ Executive Representatives
- ▶ Investment Companies
- ▶ Legal
- ▶ Mutual Funds
- ▶ Senior Management

Key Topics

- ▶ Advertising
- ▶ Exchange-Traded Funds
- ▶ Mutual Funds
- ▶ Treasury Inflation-Protected Securities

Referenced Rules & Notices

- ▶ NASD Rule 2210
- ▶ NASD IM-2210-4
- ▶ Securities Act Rule 482

Firms are reminded that these filing requirements apply to all advertisements and sales literature concerning 1940 Act ETFs, including research reports. Accordingly, firms must file research reports on these 1940 Act ETFs that fall within the definition of “advertisement” or “sales literature” within 10 business days of first use or publication.

Similarly, NASD Rule 2210(c)(2)(B) requires a firm to file advertisements and sales literature concerning public direct participation programs with FINRA within 10 business days of first use or publication. FINRA reminds firms that they must file advertisements and sales literature concerning exchange-traded products that are organized as grantor trusts and that meet the definition of “direct participation program” under FINRA Rule 2310(a)(4) within 10 business days of first use or publication.¹

Treasury Inflation-Protected Securities Funds

Treasury Inflation-Protected Securities (TIPS) are marketable Treasury securities whose par value is adjusted based upon changes in the Consumer Price Index (CPI). With inflation (a rise in the CPI), the par value of TIPS increases; with deflation (a drop in the CPI), the par value decreases.

A number of mutual funds and 1940 Act ETFs invest primarily in TIPS (TIPS funds). Often, firms will advertise a TIPS fund’s current yield as permitted by Securities Act Rule 482.² Generally speaking, a fund’s current yield is a percentage return expressed on an annualized basis that reflects the dividends and interest earned by the fund net of expenses for the 30-day period named in the communication.

Because TIPS have an inflation adjustment component that is not specifically addressed in SEC rules governing calculation of a mutual fund’s current yield, firms have adopted various treatments of the inflation adjustment when calculating a TIPS fund’s yield. Some firms have included the inflation adjustment in a TIPS fund’s current yield calculation, while other firms have not. This discrepancy in the calculation method has led to significant differences in the yield advertised by similar TIPS funds for the same periods. FINRA is concerned that investors may not understand that these differences in advertised yield are largely attributable to the different methods used to calculate current yield, rather than differences in performance of the funds themselves.

Due to this concern, FINRA has interpreted NASD Rule 2210(d) to require certain disclosures in advertisements and sales literature that include a TIPS fund’s current yield. Specifically, if the fund’s current yield is adjusted monthly based on changes in the rate of inflation, then the communication must explain that these changes can cause the yield to vary substantially from one month to the next. If an advertisement or item of sales literature includes an exceptionally high current yield for a TIPS fund, the material must disclose that the yield is attributable to the rise in the inflation rate, which might not be repeated.

Use of FINRA in Firm Trademarks

NASD Interpretive Material 2210-4 places strict limits on how firms may indicate their FINRA membership. Firms may do so only in one of three ways:

- (1) in a communication with the public that complies with the standards of NASD Rule 2210 and neither states nor implies that FINRA or any other corporate name or facility owned by FINRA, or any other regulatory organization, endorses, indemnifies or guarantees the firm's business practices, selling methods, the class or type of securities offered, or any specific security;
- (2) in a confirmation statement for an over-the-counter transaction that includes a specified legend; or
- (3) on a firm's website, so long as the firm provides a hyperlink to the homepage of FINRA's website in close proximity to the firm's indication of FINRA membership.

Recently, FINRA has observed that some firms have filed applications to register trademarks with the U.S. Patent and Trademark Office that include the FINRA® trademark and a reference to membership in the proposed trademark. Firms and their associated persons may not include the FINRA® trademark or references to FINRA membership in any trademark of the firm or associated person, as such usages violate IM-2210-4 and are likely to cause confusion and to infringe upon FINRA's trademark rights.

Identification of Related Prior Filings When Submitting New Filings for Review

FINRA reminds firms when filing material for review by Advertising Regulation staff to identify the reference number of any communication previously submitted by the firm and already reviewed by FINRA that is similar to the current communication filing. This information will assist staff in providing a more consistent and efficient review process. For example, firms should identify a past different filing that FINRA staff reviewed that includes the same or similar marketing content as the current filing. Or, if a firm files a revised version of an advertisement that the firm previously filed in order to address prior FINRA staff comments, the firm should identify the reference number of the prior filing so that prior staff comments can be addressed.

Endnotes

1. FINRA Rule 2310(a)(4) defines “direct participation program” as “a program which provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution, including, but not limited to, oil and gas programs, real estate programs, agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof.” The definition excludes real estate investment trusts, tax qualified pension and profit sharing plans pursuant to Sections 401 and 403(a) of the Internal Revenue Code and individual retirement plans under Section 408 of that Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code, and any company, including separate accounts, registered pursuant to the Investment Company Act.
2. See 17 C.F.R. 230.482(d)(1).