

Communications

Communications with The Public

FINRA rules require that advertisements include information about the securities that are offered by companies. If the firm does not have no-load funds available for purchase, they should not include them in an advertisement, to do so would be a misrepresentation and a violation of FINRA rules.

Advertisements must be approved by a registered principal prior to use. An advertisement can offer something for free when there are no strings attached.

When making a communication to the public the concern is that it is easy to mislead them. Historical illustrations based on factual performance are allowed. A research report that indicates a stock is a buy would be allowable. A product illustration that highlights how investments are different would also be ok. However, using the past to predict the future in a communication with the public is always prohibited.

There are three categories of communication with the public under FINRA rules:

- Retail communications
- Correspondence, and
- Institutional communications

Retail Communications

FINRA rules define a retail communication as a written communication, including electronic, distributed, or made available to more than 25 retail investors, within any 30-calendar-day period.

A retail investor includes any person other than an institutional investor, regardless of whether or not they are a current, former, or prospective customer of the firm.

Retail communications require principal pre-approval prior to use or its filing with FINRA.

Compliance responsibilities are the same for the broker-dealer whether communicating via the internet or other electronic media or in person.

Prospectuses and offering circulars are not considered communications regulated under FINRA rules, they are regulated by federal securities laws. Websites are included within the definition of retail communications.

Institutional Communications

Institutional communications are written communications made available to institutional clients.

Institutional communications do not require principal pre-approval, but the firm must have procedures to educate and train their associated persons the rules related to institutional communication.

An institutional communication will be treated as a retail communication any time the member has reason to believe that the communication may be made available to any investor that is not institutional.

Correspondence

FINRA rules define a correspondence as any written communication, including electronic, distributed or made available to 25 or fewer retail investors, within any 30 calendar-day period.

Correspondence is not subject to the principal pre-approval rule but may be subject to principal pre- or post-review.

The firm must have written procedures to review incoming and outgoing correspondences with the public. Evidence that the firm has supervisory procedures that are implemented and followed related to correspondence must be maintained by the firm and made available to FINRA upon request.

Firm procedures related to correspondence and institutional communications are very similar. FINRA requires the firm to have written procedures related to training associated persons in this area. The rules do not require principal pre-approval for either correspondence or institutional communications. The rules related to institutional communications require the review of these communications in a manner appropriate to the firm's size, business, structure, and customers.

New Firms

When a member firm is new, for the first year of business from registration with FINRA, they must file all retail communications with FINRA at least 10 business days prior to first use. After the firm has been in business for one year, they are considered an established firm and are then required to file retail communications with FINRA within 10 business days of first use.

Name Rule

FINRA's name rule requires that anytime a fund name has a type of security listed in it, the fund must invest at least 80% of its assets in the described investment.

Generic Advertisements

Generic advertisements can never include the name of any specific security.

Advertising Using Returns

When advertising total return for a fund, the fund must include total return for 1-, 5-, and 10-year periods, or since inception if shorter than 10 years.

When a municipal bond fund advertises using tax-equivalent yield, it must also include current yield and total return. None of the yields can be shown in greater prominence than any other.

Research Reports

A research report is written by an analyst focusing on either a particular company or sector of the economy, and often, but not always, includes a recommendation to buy, sell or hold.

FINRA is concerned about the objectivity of research reports. Due to this concern, FINRA rules require that firms clearly explain their rating systems. Firms may not tie an analyst's compensation to investment banking revenues. If the firm has received investment banking business from a company that is the subject of a research report during the previous 12 months, that fact must be disclosed. Additionally, if the firm expects or intends to solicit during the next three months investment banking business from the company that is the subject of a research report, that fact must be disclosed. The analyst must disclose in their research reports (and public appearances) whether they or any member of their household have a financial interest in the subject security and whether their employer firm owned 1% or more of any class of a subject company's equity securities at the close of the previous month.

An investment adviser or broker-dealer can use research reports prepared by others so long as it is disclosed to the client that these are research reports of others.

Research reports approval depends upon if it is used as a retail communication, institutional communication, or correspondence. If a research report is used like a retail communication, then principal pre-approval would be required.

Independently Prepared Reprints

To qualify as an independently prepared reprint (IPR) the publisher must not be an affiliate of the member using the reprint or any underwriter or issuer of the security mentioned in the reprint. Neither the member using the reprint nor the underwriter nor the issuer may have commissioned the reprinted article. All IPRs must be pre-approved by a principal and are exempt from filing with FINRA.

Public Appearances

Any time an associated person makes a recommendation during a public appearance, any personal financial interest in the security must be disclosed.

Mutual Fund Volatility Ratings

When using a bond mutual fund volatility rating the following are required disclosures: the name of the entity that issued the rating, the date of the current rating, a link to a website that includes the criteria and methodology used, a statement that there is no standard method to determine the rating, a description of the types of risk that the rating measures, and a statement that there is no guarantee the fund will continue to have the same rating in the future. FINRA rules specifically prohibit describing volatility as a risk rating.

FINRA rules define a bond's mutual fund volatility rating as a measurement of the sensitivity of the net asset value of a bond portfolio related to changes in market conditions and the general economy. It is issued by an independent third party and includes an evaluation of objective factors, such as the credit quality of the fund's individual portfolio holdings, the market price volatility of the portfolio, the fund's performance, and specific risks, such as interest rate risk, prepayment risk, and currency risk. FINRA rules specifically prohibit these ratings from being described as risk ratings.

Self-Created Ranking

When an investment company uses a ranking that is their creation or that is not generally published, the retail communication must be filed with FINRA at least 10 business days before first use.

Using Ratings in Advertisement

If in fact an investment company has been ranked #1 in a specific category, the investment company is allowed to use this in their advertisements so long as FINRA rules are followed. FINRA requires the following disclosures: the name of the category, the name of the ranking entity, criteria on which the ranking is based, the fact that past performance is not indicative of future results, and when ranking is based on total return in must include rankings based on total return for 1 year, 5 year and 10 years (or since inception, if shorter).

Records Rule

Retail communications and independently prepared reprints must be kept for three years from the date of last use. The firm must also keep a record of the names of persons preparing these communications and the name of the principal who approved their use. Records related to communications do not have to include the name of the person who prepared the communication unless the communication was not approved by a registered principal prior to use. When using a statistical table, chart, graph, or illustration in a communication, information concerning the source of the data must be kept as part of the records.

Communications Related to Variable Contracts

Communications related to variable contracts must never refer to these investments as being liquid or short-term. There can be no guarantees as to the rate of return. The separate account cannot be referred to as a mutual fund. Variable contract advertisements can include hypothetical rates of return up to 12%, so long as a 0% rate of return is also used.

Liability for False Statements

An investor who makes a purchase based upon a prospectus that includes false statements may sue the following parties to recover civil liabilities: those who signed the registration statement, directors and officers of the issuer, anyone named in the registration as about to become a director, anyone who contributed to the registration statement, and/or the underwriters.

Quarterly Statements

Any client with a cash or securities position at a brokerage firm, regardless of how recent the activity, must be sent an account statement quarterly.

Sales of Securities at a Bank

When a broker-dealer sells securities in a retail banking establishment the securities business must take place in an area separate from where the retail deposits are taken.

When a broker-dealer does business in the premises of a bank there are many requirements under FINRA rules:

- The broker-dealer's name must be clearly displayed
- The business must be held in a place that is physically separate from where the retail deposits are taken, and
- At or prior to the opening of the securities account there are disclosures that must be made both in writing and verbally. These disclosures include the fact that the securities being purchased are not insured by the FDIC, are not deposits of the bank, and are subject to investment risks, including the possible loss of the principal invested.

Summary Prospectus

Mutual fund issuers may distribute a summary prospectus to an investor that includes an application. The summary prospectus includes key information from the statutory prospectus. Investors may purchase shares from the summary prospectus application, or they may request a statutory prospectus.

Statement of Additional Information

An SAI must be provided to an investor upon request, with no charge.

Telemarketing

FINRA Rule 3230 is the telemarketing rule, it allows for solicitation calls to be made to prospective clients from 8 am-9 pm of the time zone in which the person being called lives. The rule allows for an associated person to call a person with whom they have a personal relationship at any time.

Telemarketing rules also allow for a registered representative to call a client who is on the do-not-call list because the telemarketing rules do not apply to people that the firm has an established business relationship with. Should a client of a firm request to be put on the firm's do-not-call list, then the firm may no longer solicit the client via telephone.

Calling a referral from a customer before 8 am would be a violation of the telephone solicitation regulations.

Taping Rule

When a firm has been advised by FINRA that it must tape record all conversations they have 60 days to implement the requirement. A firm that is subject to FINRA's taping rule must record all telephone conversations, with both new and prospective clients, for three years.

When a brokerage firm has 10-19 registered representatives and then hires four or more new representatives that were associated with a disciplined firm at some point in the previous three years, the taping rule applies.

If a brokerage firm has 20 or more registered representatives, the taping rule is triggered when they hire 20% or more registered representatives from disciplined firms.

A firm that has been notified by FINRA that they are subject to the taping rule is allowed a one-time opportunity to reduce its staffing levels to below the threshold limits. It must do so within 30 days of receiving written notice from FINRA.