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## FINRA Allows Use of Related Performance Information in Communications Regarding Mutual Funds with Financial Intermediaries and Other Institutional Investors

MAY 18, 2015

### Overview and Background

On May 12, 2015, the staff of the Financial Industry Regulatory Authority (FINRA staff) issued an interpretive letter to Hartford Funds Distributors, LLC (Hartford Funds) that conditionally allows distributors of mutual funds to include certain types of related performance information in communications with institutional investors, including registered broker-dealers and investment advisers.<sup>1</sup> In other words, mutual fund distributors for the first time may include related performance information in sales literature when selling or recommending mutual fund shares to institutional investors and communicating with financial intermediaries.

FINRA Rule 2210 generally governs communications with the public. Paragraph (d) of the rule includes general content standards. Historically, FINRA staff has taken the position that the presentation of related performance information in public communications regarding mutual funds is inconsistent with those content standards. In this context, related performance information generally means the performance of other accounts or funds that have similar investment policies, objectives and strategies and are managed by the same adviser. Many financial intermediaries believe that such related performance information is valuable for due diligence purposes in assessing the capabilities of a mutual fund's adviser. This is especially relevant where the adviser has been managing assets in the same strategy as the mutual fund and either the mutual fund is new (and therefore does not have its own performance record) or the mutual fund's performance record is shorter than that of the adviser. The FINRA staff position does not limit the use of related performance information to mutual funds that do not have performance records or that have only short-term performance records. However, for mutual funds that have performance records of at least one year, the fund's performance record must be displayed more prominently than the related performance information in the institutional communications.

In 2003, FINRA staff stated that it would not object if a member firm included related performance information in sales materials for private funds relying on Section 3(c)(7) of the Investment Company Act of 1940, if that information was made available only to qualified purchasers, as

defined in the Investment Company Act, subject to the general content requirements of NASD Rule 2210 (the predecessor rule to FINRA Rule 2210). However, FINRA staff had not ever agreed that related performance information could be included in communications regarding mutual funds. In part for that reason, many mutual funds chose to include related performance information in the prospectuses, but could not include the same information in sales literature.

### **Conditions of the Letter**

In its request, Hartford Funds proposed to provide related performance information solely to institutional investors, subject to the following conditions:

- The performance information may be provided only if it is the actual performance of all separate or private accounts or funds that (1) have substantially similar investment policies, objectives, and strategies, and (2) are managed or were previously managed by the same adviser or subadviser that manages the registered mutual fund that is the subject of an institutional communication (Related Performance Information).
- Hartford Funds will provide materials containing Related Performance Information only to persons who qualify as "institutional investors" under FINRA Rule 2210(a)(4), excluding institutional investors who intend to share the Related Performance Information with persons other than institutional investors. (Rule 2210 defines institutional investor to include a bank, savings and loan association, insurance company, registered investment company, investment adviser registered with the Securities and Exchange Commission or a state securities commission, any other person with total assets of at least \$50 million, governmental entity or subdivision thereof; an employee benefit plan that meets the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and has at least 100 participants, but not any participant of such a plan; a qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, that has at least 100 participants, but not any participant of such a plan; a FINRA member or registered associated person of such a member; and a person acting solely on behalf of any institutional investor.)
- The presentation of Related Performance Information will include all accounts described in the first condition (Related Accounts). If there are multiple Related Accounts, the investment performance of such accounts will be presented in a composite or a list in which the investment performance of each account will be displayed with equal prominence.
- Any institutional communication with Related Performance Information will be clearly labeled "for use with institutions only, not for use with retail investors." The distributor will instruct institutional investors who receive such materials not to provide them to current or prospective customers or others who are not institutional investors.
- The presentation of Related Performance Information will disclose the performance net of fees and expenses of Related Accounts, or net of a model fee that is the highest fee charged to any account managed in the strategy. If gross performance information is also provided, the institutional communication will disclose prominently that the performance information does not reflect the deduction of fees and expenses, different funds and accounts have different fees and expenses, and the Related Performance Information would have been lower to the extent the related funds or accounts were subject to higher

fees and expenses. The fees and expenses of the registered mutual fund that is the subject of the institutional communication will be prominently disclosed and the fund's performance information will reflect all fees and expenses. If the fees and expenses are higher than the fees and expenses of the Related Accounts, that fact will be disclosed.

- Related Performance Information will include the performance of each related account, be for a period of at least one year and since the inception of the investment strategy, and be current as of the most recently ended calendar quarter.
- Related Performance Information will be clearly labeled as such and contain clear disclosure of the applicable dates for the performance.
- For a mutual fund in existence more than one year, its actual performance will be displayed more prominently than the Related Performance Information.
- The institutional communications will disclose any material differences between the Related Accounts and the mutual fund that is the subject of the institutional communication.

## Conclusion

The interpretation takes effect immediately, meaning that mutual funds and their distributors may now provide Related Performance Information to financial intermediaries and institutional investors without concern that FINRA staff will deem the communications to violate Rule 2210. This should enable mutual fund groups to provide more meaningful information to those intermediaries and institutional investors to enable them to evaluate mutual fund products.

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<sup>1</sup> WilmerHale represented Hartford Funds in connection with this letter.

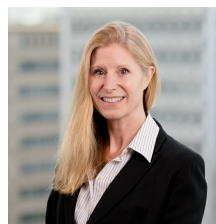
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