CREDIT SUISSE

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March 27, 2017

VIA ELECTRONIC MAIL

Marcia E. Asquith
Senior Vice President and Corporate Secretary
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

Re: FINRA Regulatory Notice 17-06, Communications with the Public

Dear Ms. Asquith:

Credit Suisse Securities (USA) LLC ("Credit Suisse") appreciates the opportunity to comment on FINRA Rule 2210 and its application generally, as discussed in Regulatory Notice 17-06 ("Notice 17-06"). Notice 17-06 follows a retrospective review that FINRA conducted regarding its rules governing communications with the public. In the Notice, FINRA proposes to allow greater flexibility to broker-dealers to use hypothetical performance, subject to a number of safeguards, in order to "better inform investors about the recommended investment strategies, including the underlying assumptions upon which the recommendations are based" and to allow clients to receive the same types of projections-related communications from broker-dealers as they do from investment advisory firms. Although the proposal described in Notice 17-06 focuses exclusively on provision of projected performance to retail investors, we believe that the themes addressed in the letter are even more relevant and important in the institutional context. We therefore urge FINRA to couple the changes FINRA proposes to make to Rule 2210 regarding retail communications with appropriate changes to Rule 2210 for institutional communications. In particular, we urge FINRA to: (A) exempt institutional communications from the provisions of Rule 2210(d)(1)(F) to permit the use of hypothetical[1] performance in institutional communications; (B) allow institutional communications to show both hypothetical and historical performance gross of fees provided that the communication prominently

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[1] We use the terms "hypothetical performance" and "projected performance" interchangeably to mean all types of estimated information referenced in FINRA Rule 2210(d)(1)(F), including projections, back-tested performance, simulations, hypotheticals and related performance.

discloses fund fees and expenses; (C) clarify that target performance provided in institutional communications would not be projected performance and may be included in such communications so long as there is a reasonable basis for the target return and the communication explains the circumstances under which the target would not be achieved; (D) in connection with institutional communications and subject to appropriate disclosure regarding the basis for such information, exclude from the definition of projected performance, information regarding specific investments made or to be made by a private fund or a related fund; and (E) clarify that model-based projections and back-tested performance may provide a reasonable basis for projected performance and target returns in institutional communications.

We believe that these changes would benefit investors by allowing funds to provide prospective investors with the information that these investors uniformly request and need in order to evaluate private fund investments – both at inception and throughout the life of the fund. Moreover, by allowing broker-dealers to provide a more expansive set of information to investors about a fund's strategy (consistent with what may be provided by investment advisers), FINRA would help to eliminate confusion currently caused by the use of different types of offering materials by investment advisers and broker-dealers due to the different regulatory standards provided by the Securities and Exchange Commission (the "SEC") and FINRA. We also believe that disclosure standards should not disadvantage funds that use registered broker-dealers to assist in marketing their products or disincent funds from using registered broker-dealers. Finally, we believe that the changes we describe are necessary to strengthen and expand our U.S. capital markets by expanding the information available to institutional accounts and encouraging issuers to participate in the U.S. market. As the SEC has acknowledged in other contexts, the securities markets benefit from provision of more information to investors[2] and projections and forward-looking information provide investors with an important means of evaluating investments.[3] Current FINRA guidance does not allow for use of projections by broker-dealers unless expressly requested by an investor and then, only in connection with a one-on-one meeting with a particular investor representative. This approach results in an unlevel playing field in which some investors receive more information than others. In addition, providing simulations and projection tools to investors to allow them to evaluate and "test" the thesis underlying an investment strategy is consistent with regulatory efforts to make disclosure more relevant and user-friendly to investors.[4] In our experience, institutional investors want to carry out a rigorous simulation of fund

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[2] *See, e.g.,* Securities Offering Reform Release No. 33-8591 (July 19, 2005), 70 FR 44722 at 44725 (Aug. 3, 2005)(stating, in respect to free writing prospectuses "consistent with our belief that investors and the securities markets will benefit from greater permissible communications by issuers while retaining appropriate liability for these communications, we have sought to address the need for timeliness of information for investors by building on existing statutory provisions and processes without mandating delays in the offering process that we believe would be inconsistent with the needs of issuers for timely access to the securities markets and capital.")

[3] Safe Harbor Rule for Projections, Rel. No. 33-6084, 44 Fed. Reg. 38,810 (June 25, 1979)(Noting that the SEC adopted the rule expressly to encourage the disclosure of projections and forward-looking information by issuers, as recommended by the Sommer Report).

[4] *See* Concept Release on Business and Financial Disclosure Required by Regulation S-K; 17 CFR Parts 210, 230, 232, 239, 240 and 249; Release Nos. 33-10064, 34-77599; File No.S7-06-16; RIN 3235-AL78, 81 Fed. Reg. 23,916 (Apr. 22,

performance prior to investing and look to funds and broker-dealer placement agents to provide them with the information necessary to "kick the tires".

We do not believe that maintaining a broad prohibition on the use of projected performance is necessary. Actions against persons who offer securities based on misleading disclosure should and can be brought under the anti-fraud provisions of the federal and state securities laws. A separate prohibition by FINRA is not necessary to protect the markets. All broker-dealer communications must be fair and balanced and comply with federal and state anti-fraud provisions.

FINRA has recognized that many institutional accounts are sufficiently sophisticated and able independently to evaluate recommendations and investments so that they do not require the protections of FINRA rules, such as those of the customer-specific suitability standard under Rule 2111. We ask FINRA to acknowledge that broker-dealers may provide to these same sophisticated investors the target return, related performance, performance simulations, hypothetical performance, back-tested returns and projection information these investors routinely seek as part of their due diligence process.

A. Exempt Institutional Communications from Rule 2210(d)(1)(F)

In connection with the proposed exemption from the projected performance prohibition discussed in Notice 17-06, FINRA made an important observation about the policy objective underlying the prohibition. Notice 17-06 states that the prohibition was designed primarily to protect "retail" investors.[5] The clear implication of the language is that the standard was not intended to focus on "institutional" investors. This distinction is consistent with the exemption for institutional communications from the filing requirements in Rule 2210 and the more permissive approval requirements for institutional communications provided by Rule 2210 for institutional communications. Those exemptions recognize that a mandated review process is not necessary for marketing materials given the greater sophistication of institutional investors.

Similarly, the suitability standard under FINRA Rule 2111 distinguishes between retail investors and institutional investors.[6] Although Rule 2111 provides an exemption only if, among other requirements, a broker-dealer makes a determination that an institutional investor is able to evaluate the risks underlying the particular investment, the Rule does not provide a parallel exemption with respect to retail investors – even if the broker-dealer were to determine that the retail investor was able

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2016)(describing the initiative by the Division of Corporation Finance to consider ways to improve disclosure to benefit investors); Fast Act Disclosure Modernization and Simplification, Pub. L. No. 114-94, 129 Stat. 1312 (2015)(Requiring a study of Regulation S-K to "evaluate methods of information delivery and presentation" and "maintaining the informativeness of disclosure").

[5] *See* Notice 17-06, p. 2 "The general prohibition against performance projections is largely intended to protect retail investors from performance projections of individual investments, which often prove to be spurious, inaccurate or otherwise misleading."

[6] The exemption in Rule 2111(b) applies to "institutional accounts" as defined in FINRA Rule 4512(c).

to evaluate the risks.[7] As a result, the suitability standard, which arguably is the central requirement for broker-dealer conduct, is a recognition that it is reasonable not to prescribe specific conduct requirements for broker-dealers when dealing with sophisticated institutional investors but, instead, to rely exclusively on general anti-fraud principles, such as those inherent in Rule 1210 (Standards of Commercial Honor and Principles of Trade), to deter bad conduct.

Consistent with FINRA's general recognition that institutional investors do not need the same specific protections as retail investors with respect to broker-dealer communications, we respectfully request that FINRA take this opportunity to exempt institutional communications altogether from the projected performance prohibitions of Rule 2210(d)(1)(F). In our view, providing such an exemption would benefit both investors and our U.S. capital markets generally by allowing funds to be marketed with more complete information thereby allowing investors to make a better informed investment decision. In order to ensure that the recipients of the communications are the sophisticated users to whom the communications are addressed, funds could be required to include prominent disclosures and "health warnings" on the materials advising that they are intended exclusively for sophisticated and experienced institutional accounts, such as registered investment advisers.

B. Allow Institutional Communications to Show Performance on a Gross Basis

As a policy matter, FINRA has required performance information to be shown net of fees.[8] This position follows the position taken by the SEC staff in a no action letter requiring performance figures to reflect fees.[9] We understand that this type of presentation may be appropriate for retail investors. However, in our experience it is not appropriate for institutional investors. Prospective investors in private equity, real estate and credit funds generally ask to see financial returns and estimated returns regarding portfolio company investments in the form provided by the portfolio company. Portfolio company reporting is done on a gross basis rather than on a net basis. Use of net information instead of the gross financial information provided by the portfolio companies results in investor confusion because the financial information provided by the fund differs from that provided by the portfolio company. We respectfully request that FINRA allow marketing materials for funds marketed through broker-dealers to provide performance information to institutional accounts,

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[7] Rule 2111(b) provides: "A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in Rule 4512(c), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decisionmaking authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent."

[8] *See, e.g.*, FINRA Letter to Edward P. Macdonald, Hartford Funds Distributors, LLC (May 12, 2015)(the "FINRA Hartford Letter")(conditioning provision of related performance information to institutional accounts on such performance being "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.")

[9] Clover Capital Management, Inc., SEC No-Action Letter, 86-87 CCH Dec., Fed. Sec. L. Rep (CCH) ¶78,378 (Oct. 28, 1986).

including, without limitation, related performance (which FINRA has authorized broker-dealers to include in marketing materials provided to investors that are qualified purchasers – which is a lower standard than institutional accounts)[10] on a gross basis provided that the fees and expenses charged by the fund are also clearly and prominently disclosed in the same materials. This is consistent with the specific requests for presentations that we receive from investors. In addition, preparation of pro forma return information for specific underlying investments, which is particularly important to institutional investors when evaluating whether to invest in a private equity, real estate or credit fund, is extremely difficult to do on an investment by investment basis and may not be accurate because management fees are applied on a fund level.

C. Clarify either that Target Returns are not Projected Performance or that they May be Included in Institutional Communications

Target returns are provided to prospective investors for the purpose of describing the intended risk profile of a fund or investment. Unlike a projection, a target return does not purport to be an estimate of future returns. Instead, a target return is designed to help prospective investors evaluate how the risk profile of a fund will fit into the investor's portfolio and investment objectives. Prospective investors in private funds and, in particular, private equity, real estate and credit funds, require target return information about the fund itself and its underlying investments before they can begin to evaluate a fund. For certain institutional investors, the level of the target returns reflected in the marketing materials is critical in selecting which internal portfolio manager should be selected to evaluate the proposed investment since prospective investments are often ranked by risk/return profile.

FINRA has suggested in enforcement actions that target returns may constitute "projected performance" of the type prohibited by Rule 2210(d)(1)(F). We do not agree that target returns are projections. As discussed in Notice 17-06, we believe that target returns are more akin to a price target used in research reports and should be allowed in both institutional and retail communications so long as the returns are premised on reasonable basis assumptions and include a full and fair description of the investment's risk profile.

To the extent that FINRA believes that target return information is inherently subject to misunderstanding by unsophisticated investors, we ask that FINRA distinguish between retail and institutional investors and exempt the use of target returns in institutional communications. Institutional investors employ sophisticated diligence teams to review prospective investments and

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[10] FINRA Letter to Yukako Kawata, Esq., Davis Polk & Wardwell (Dec. 30, 2003), at http://www.finra.org/industry/interpretive-letters/december-30-2003-1200am (finding that prior FINRA guidance that prohibited members from presenting related performance information in sales material for private equity funds did not apply to presentation of related performance information to prospective investors in funds exempt from registration under the Investment Company Act of 1940 by virtue of Section 3(c)(7)); *see also* FINRA Letter to Bradley J. Swenson, ALPS Distributors, Inc. (Apr. 22, 2013), at http://www.finra.org/industry/interpretive-letters/april-22-2013-1200am (authorizing the use of pre-inception index performance in communications regarding certain exchange traded products distributed solely to "institutional investors" as defined in FINRA Rule 2210(a)(4)) and FINRA Hartford Letter (authorizing disclosure of performance information related to related mutual funds and accounts managed by the same adviser or sub-adviser to financial intermediaries in connection with wholesale distribution of mutual funds).

those personnel closely scrutinize target information and are well-able to evaluate the information in order to make an informed investment decision.

D. Confirm that Estimated Returns about Underlying Fund Investments provided to Institutional Accounts are not Subject to Rule 2210(d)(1)(F)

The relief that FINRA has proposed in Notice 17-06 distinguishes between projections relating to investment strategy and projections relating to individual securities. The Notice acknowledges that "information regarding the expected performance of an asset allocation or other investment strategy that does not project the performance of individual securities could better inform an investor about assumptions upon which the recommendation to pursue such a strategy is based."[11]

In the context of private equity, real estate and credit funds, projections regarding the investment strategy are essential to the diligence process of institutional investors and involve estimates and information regarding the projects in which the funds seek to invest. In the real estate fund context, for example, investment strategy is detailed by region, types of real estate holdings and sample investments made by other funds, including realized or expected returns. Similarly, in the private equity context, funds may describe the investment strategy by providing examples of previous investments and estimated returns on prior investments that are still in the process of being monetized. In our view, these disclosures describe the strategy pursued by the fund and are not projections relating to securities of the type prohibited by Rule 2210(d)(1)(F). We ask that FINRA confirm our interpretation of the requirement and allow broker-dealers and funds marketed through broker-dealers to institutional accounts to provide this type of information to prospective investors just as investment advisers and funds not marketed through broker-dealers are already allowed to do. As Notice 17-06 recognizes, expanding the ability of broker-dealers to describe a fund's investment strategy would "better harmonize regulatory standards and allow firms to communicate, subject to limitations, information regarding the expected performance of an asset allocation or other investment strategy."[12]

E. Clarify that Model Returns and back-tested performance can provide a Reasonable Basis for Projected Performance and Target Returns in Institutional Communications

The SEC and the common law have historically allowed investment advisers to provide investors with different types of hypothetical performance so long as the assumptions underlying the hypotheticals are disclosed, the presentation is not misleading and the adviser has a reasonable basis for the projections.[13] Other regulatory or self-regulatory authorities also allow intermediaries to

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[11] Notice 17-06 at p. 2.

[12] *Id.* at 4.

[13] *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47-48 (2d Cir.), *cert. denied,* 439 U.S. 1039 (1978) ("...a potential investor can reasonably assume that an investment advisor has a reasonable basis in fact for making predictions. Representations and opinions made without factual basis and in reckless disregard of their truth or falsity are therefore actionable"); *Marx v. Computer Sciences Corp.*, 507 F.2d 485, 489 (2d Cir. 1974).

provide projected performance in communications with the public, including to both retail and institutional investors, so long as the presentations are fair and not misleading, the projections have "a reasonable basis in fact" and the intermediary who uses the projections keeps a copy in its files of the basis for its analysis.[14] In Notice 17-06, FINRA explained that its proposal to allow broker-dealers to distribute customized hypothetical investment planning illustrations to retail investors is conditioned on there being a reasonable basis for the projections. In explaining what is meant by "a reasonable basis," FINRA notes that "historical performance and performance volatility of asset classes, the duration of fixed income investments, the effects of macroeconomic factors such as inflation and changes in currency valuation, the impact of fees, costs and taxes and expected contribution and withdrawal rates by customers" might be sufficient to establish a "reasonable basis" for projected performance whereas "basing a projection upon hypothetical back-tested performance" or on "past performance of particular investments by an asset manager" would not be.[15]

Institutional investors generally require performance data in evaluating private fund investments. In situations where a portfolio manager does not have an established track record, model-based performance or back testing may be the only approaches available to provide performance information and a basis to support hypothetical performance. Model based results as well as back tested data, so long as they are prepared in a balanced manner, are appropriately labelled and include assumptions, can provide useful information for prospective investors regarding a new fund's financing needs, expected cash flow, investment mix and risk profile and investment timeline, among other things. This information – even if illustrated through model-based examples -- enhances the investor's understanding of the underlying strategy, allows the investor to understand the manager's approach and highlights questions that the prospective investor may have regarding the assumptions and strategy. Model returns can also provide a yardstick for institutional investors to use to track performance of investments going forward. We believe that the information provided through models is understood by institutional investors and is an essential part of their due diligence process – particularly in situations where a fund manager does not have a track record. As a result, we respectfully request that FINRA clarify that use of model-based results and back testing, if conducted in a fair and balanced manner, would provide a reasonable basis for supporting projected performance and target returns to institutional accounts, as defined in FINRA Rule 4512(c).

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[14] *See* NFA Compliance Rule 2-29; Use of Past or Projected Performance; Disclosing Conflicts of Interest for Security Futures Products (Aug. 21, 2001)(Allowing for the use of past or projected performance in communications with the public subject to specified conditions including that the projected performance have a reasonable basis in fact and that records be maintained showing how performance was calculated); and U.K. Financial Conduct Authority Conduct of Business Sourcebook (allowing for simulated performance, hypothetical performance, future performance and projections by regulated intermediaries, treating such written communications as "non-real time promotions," and requiring such communications to be clear, fair and not misleading; use with retail investors is expressly allowed but subjects the publisher to certain additional restrictions).

[15] Notice 17-06 at 3.

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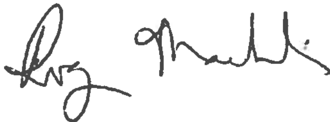
We appreciate the opportunity to comment on Notice 17-06 and on FINRA Rule 2210, more generally. We would be pleased to discuss our comments with FINRA or to provide FINRA with assistance as it proceeds to evaluate its Rule. Please do not hesitate to contact the undersigned at 212-325-4495 or roger.machlis@credit-suisse.com regarding this letter.

Sincerely yours,



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