



## Interpretive letter to Meredith F. Henning, Foreside

**A member firm may include pre-inception index performance data in institutional communications concerning registered open-end investment companies, subject to the stated conditions discussed in the letter.**

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Dear Ms. Henning:

In your letter of January 22, 2019, you request interpretive guidance on behalf of Foreside Fund Services, LLC ("Foreside"), a registered broker-dealer, regarding the use of pre-inception index performance ("PIP") data in communications concerning open-end investment companies, including separately-managed series of a business trust, that are distributed solely to institutional investors as defined in FINRA Rule 2210(a)(4).<sup>1</sup> PIP data model the performance of an index had it existed prior to the inception date thereof.

### Background

You state that ABR Dynamic Funds, LLC ("ABR") serves as investment adviser to several open-end investment companies registered under the Investment Company Act of 1940 and the Securities Act of 1933, including the ABR Dynamic Blend Equity & Volatility Fund (the "Fund"), a separately-managed series of Forum Funds II (the "Trust"). Foreside serves as the principal underwriter for the Trust.

You state that the Fund seeks to generate investment results that correspond generally to the performance, before fees and expenses, of a benchmark index. The benchmark index for the Fund is the ABR Dynamic Blend Equity & Volatility Index Powered by Wilshire (the "Index"). The Index was developed according to pre-defined rules that cannot be altered except under extraordinary market, political or macroeconomic conditions. The Fund is managed in accordance with the Index, and under normal circumstances invests at least 80% of the value of its net assets in investments in equity securities and derivative instruments that provide exposure to the constituents of the Index. Since it began operations, the Fund's performance has closely correlated to that of the Index.

You state that broker-dealers and investment advisers that fall within the definition of "institutional investor" under FINRA Rule 2210(a)(4) have requested that Foreside provide them with PIP data regarding the Index. These institutional investors in turn may recommend the Fund to their advisory or brokerage customers, and are responsible for discharging their suitability and other regulatory obligations when doing so. Foreside believes that institutional investors are able to understand the potential benefits and drawbacks of such information.

In preparing and using institutional communications for the Fund containing PIP data, Foreside agrees to adhere to the following conditions:

1. Any piece of marketing material that includes PIP data will be clearly labeled "For use with institutions only, not for use with retail investors." If the recipient is a financial intermediary, the recipient will be instructed not to circulate communications containing PIP data to retail investors.
2. Any PIP data will be used only with respect to the Index, which was created according to a pre-defined set of rules that cannot be altered except under extraordinary market, political or macroeconomic conditions.
3. PIP data will not be used to market the Fund if the Fund alters its investment strategy to permit active management of the Fund's securities portfolio.
4. Any marketing material containing PIP data will include an offer to provide an overview of the methodology of the index upon request and electronic marketing material will include a hyperlink to such information.

5. The presentation of PIP data will reflect the deduction of fees and charges currently applicable to the Fund.
6. PIP data will reflect a period of time that includes multiple securities market environments, and at a minimum, ten years of pre-inception data.
7. PIP data will be current as of the most recently ended calendar quarter.
8. PIP data will be clearly labeled and shown separately from Fund performance and will be presented along with disclosure of the applicable dates for the PIP data and the dates for actual performance since inception.
9. As the Fund has been in existence for more than one year, the use of PIP data will be accompanied by the prominent presentation of actual performance of the Fund since inception that reflects the deduction of fees and charges of the Fund.
10. PIP data will not be inconsistent with information in the prospectus but may be used regardless of whether the fund prospectus contains the data.
11. PIP data will be accompanied by the following disclosures:
  - i. The Fund is a relatively new product and any performance prior to the date of inception is hypothetical;
  - ii. The identity of the entity that performs the calculation and distribution of the PIP data, and the fact that ABR pays this entity to perform those functions;
  - iii. The fact that PIP data are based on criteria that has been applied retroactively with the benefit of hindsight, and that these criteria cannot account for all financial risk that may affect the actual performance of the Fund;
  - iv. The actual performance of the Fund may vary significantly from the PIP data; and
  - v. Reasons (if any) why the PIP data would have differed from actual performance during the period shown (e.g., transaction costs, liquidity, or other market factors).

In addition, your letter states that all marketing materials that contain PIP data will comply with applicable FINRA rules and federal securities laws and will be subject to the same supervisory and approval requirements that Foreside applies to all other institutional communications. If Foreside becomes aware that a recipient has distributed materials containing PIP data to retail investors, Foreside will cease distributing such materials to that recipient.

## Discussion

FINRA Rule 2210 subjects institutional communications to specified content and supervision standards. In particular, institutional communications must be fair and balanced and must provide a sound basis for evaluating the facts in regard to any particular security. Institutional communications may not omit material information, include false, exaggerated, or misleading statements, or misstate material facts. A firm must establish written procedures for the review of institutional communications by a registered principal that are appropriate to the firm's business, size, structure, and customers.

FINRA staff has stated previously that FINRA Rule 2210 permits the use of PIP data in institutional communications in the manner proposed in this letter. In its 2013 letter to ALPS Distributors, Inc., FINRA staff stated that communications relating to exchange-traded products containing PIP data provided only to institutional investors were consistent with FINRA Rule 2210, subject to specified conditions regarding the presentation and use of such data.<sup>2</sup>

While we do not object to the use of PIP data in institutional communications as discussed herein, this letter does not affect FINRA's long standing position that the presentation of hypothetical back-tested performance in communications used with retail investors does not comply with FINRA Rule 2210(d).

The opinions expressed in this letter are staff opinions only and have not been reviewed or endorsed by the FINRA Board of Governors. This staff letter responds only to the issues raised, and does not address any other rule or interpretation of FINRA, or all the possible regulatory and legal issues involved.

If you have any questions regarding this letter, please contact me at (240) 386-4534.

Sincerely,

Joseph P. Savage

cc: John H. Grady, DLA Piper LLP

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<sup>1</sup> FINRA Rule 2210(a)(4), the term "institutional investor" means any person described in FINRA Rule 4512(c), regardless of whether that person has an account with the FINRA member; governmental entity or subdivision thereof; 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 does not include any participant of such a plan; qualified plan, as defined in Section 3(a)(12)(C) of the Securities Exchange Act of 1934, as amended, that has at least 100 participants, but does not include any participant of such a plan; FINRA member or registered associated person of such a member; and person acting solely on behalf of any such institutional investor.

<sup>2</sup> See Letter from Joseph E. Price to Bradley J. Swenson, ALPS Distributors, Inc. (April 23, 2013), available at [www.finra.org](http://www.finra.org).

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