ALI-CLE CONFERENCE ON LIFE INSURANCE COMPANY PRODUCTS 2023

November 2 - 3, 2023

TAILORED SPECIFICALLY: RECENT SEC REGULATORY DEVELOPMENTS RELATING TO ADVERTISING

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"I have other concerns, including the overlap between our amended investment company advertising rules and FINRA's communications rules, but I think you get the point that today's rulemaking is not perfect. I can ultimately support it, however, because fund shareholders will benefit from this trimmed-down, layered approach to disclosure. I hold out the hope that we look at these changes as the beginning and not the end of an ongoing process."

Commissioner Hester M. Peirce, *One Good Step, More to Go: Statement on Final Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements* (Oct. 26, 2022).

[1] The author thanks Richard Choi, Gary Cohen, and Thomas Lauerman of Carlton Fields, P.A., for their valuable contributions to this outline. The author's views do not necessarily reflect the views of her law firm, the law firm's individual shareholders and other lawyers, or any of the law firm's clients.

CARLTON FIELDS

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I. INTRODUCTION AND OVERVIEW

Gary Gensler's tenure-to-date as Chairman of the Securities and Exchange Commission ("**SEC**") is striking for its exceptionally active rulemaking agenda. Two rulemakings of tremendous import to issuers and distributors of insurance products – ***tailored shareholder reports*** for mutual funds and exchange traded funds ("**ETFs**")[2] and a ***registration form tailored for*** registered index-linked annuities ("**RILA's**")[3] – include amendments to advertising rules under the Securities Act of 1933 ("**Securities Act**") and the Investment Company Act of 1940 ("**1940 Act**").

As part of the tailored shareholder report rulemaking, the SEC adopted amendments to Rules 482, 433, and 156 under the Securities Act and Rule 34b-1 under the 1940 Act "to promote transparent and balanced presentations of fees and expenses."

The release proposing registration of RILAs under the Securities Act on a tailored Form N-4 proposes amendments to Rules 156 and 172 under the Securities Act to treat offerings of RILAs like offerings of variable annuities. Yet the rulemaking proposal does not propose amending Rule 482 under the Securities Act to permit RILAs to use an "omitting prospectus."

In addition to addressing recent advertising rule amendments, and proposed amendments, this outline discusses a significant enforcement trend tangentially related to advertising, namely, recordkeeping and supervision violations involving "off-channel communications."[4] For those interested in this enforcement trend, the

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[2] SEC Final Rule, *Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements*, Securities Act Release No. 11125, Exchange Act Release No. 96158, Investment Company Act Release No. 34731 (Oct. 26, 2022) [hereinafter "**Tailored Shareholder Report Adopting Release**"].

[3] SEC Proposed Rule, *Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities*, Securities Act Release No. 11250, Exchange Act Release No. 98624, Investment Company Act Release No. 35028 (Sept. 29, 2023) [hereinafter "**RILA Form Proposing Release**"]. A RILA is an annuity that is registered with the SEC, issued by an insurance company, not issued by an investment company, and the returns of which "(i) are based on the performance of a specified benchmark index or rate (or a registered exchange traded fund that seeks to track the performance of a specified benchmark index or rate); and (ii) may be subject to a market value adjustment if amounts are withdrawn before the end of the period during which that market value adjustment applies." *Registration for Index-Linked Annuities Act*, S.3198, 117th Congress, incorporated into H.R. 2617, *Consolidated Appropriations Act*, 2023, and signed by President on Dec. 29, 2022.

[4] The SEC enforcement orders define the term "off-channel communications" to mean "using personal devices, [broker-dealer and investment adviser] employees communicate[] both internally and externally by personal text messages, or other text messaging platforms such as WhatsApp and GroupMe." *See, e.g., In the Matter of Interactive Brokers*, Exchange Act Release No. 98633 (Sept. 29, 2023).

last part of the outline includes a chart of off-channel communication enforcement matters to date to serve as a resource.

II. RECENT CHANGES TO INVESTMENT COMPANY ADVERTISING RULES

A. Amendments Adopted in Tailored Shareholder Report Adopting Release

1. In the same release adopting a tailored shareholder report framework for investment companies and ETFs, the SEC adopted amendments to certain investment company advertising rules, including Rules 482, 433, and 156 under the Securities Act and Rule 34b-1 under the 1940 Act ("**Investment Company Advertising Rules**"). The rule amendments became effective on January 24, 2023. The compliance date for amended Rules 482, 433, and 34b-1 is July 24, 2024, following an 18-month transition period. The SEC did not provide an extended compliance date for amended Rule 156.

2. The SEC's expressed purpose for amending the Investment Company Advertising Rules was to address "**fee comparability**" in investment company advertisements "to promote transparent and balanced presentations of fees and expenses." The SEC explains in the adopting release as follows: "As funds are increasingly marketed on the basis of costs, we remain concerned that investment companies and intermediaries may, in some cases, be incentivized to understate or obscure the costs associated with a fund investment." *Id.* at 186.

3. Changes to the SEC's advertising rules were not without opposition. For example, the Investment Company Institute ("**ICI**") opposed the rule amendments because, among other reasons, "the robust SEC advertising rules and FINRA rule 2210 more than suffice to inform investors of the fees and costs of investing." Comment Letter of the Investment Company Institute (Dec. 21, 2020).

4. Even though the SEC adopted advertising rule changes in the same rulemaking as tailored shareholder reports, the amended disclosure requirements "do not apply to any quarterly, semi-annual, or annual report to shareholders under Section 30 of the 1940 Act or to other reports pursuant to Section 13 or Section 15(d) of the [Securities] Exchange Act [of 1934 ("**Exchange Act**")] containing fee and expense information."

B. Amendments to Rule 482

1. Pursuant to Rule 482, investment company advertisements are deemed to be "omitting prospectuses" that may include information the substance of which is not included in a fund's statutory or summary prospectus.

2. New Rule 482(i) requires advertisements providing **fee or expense figures** to include:

    a. the maximum amount of any sales load, or any other nonrecurring fee, and the total annual expenses without any fee waiver or expense reimbursement arrangement, based on the methods of computation prescribed by the investment company's registration statement form under the 1940 Act or under the [Securities] Act for a prospectus and presented at least as prominently as any other fee or expense figure included in the advertisement; and

    b. the expected termination date of a fee waiver or expense reimbursement arrangement, if the advertisement provides total annual expenses net of fee waiver or expense reimbursement arrangement amounts.

3. This requirement applies only if the advertising piece presents fee and expense figures.

4. New Rule 482(i)(1) includes a **prominence requirement**. Advertisements that present fee or expense figures must present the required fee and expense figures at least as prominently as any other included fee or expense figures included in the advertisement.

5. Similar to Form N-1A prospectus disclosure requirements, new Rule 482(i)(2) requires advertisements that include a fund's total annual expenses net of fee waiver or expense reimbursement arrangement amounts also to include the expected termination date of the arrangement.

6. New Rule 482(j) includes a **timeliness requirement** that requires fee and expense information to be as of the date of the fund's most recent prospectus or, if the fund no longer has an effective registration statement, its most recent annual report. If available, more recent information may be presented.

C. Amendments to Rule 433

1. Registered closed-end funds and business development companies ("**BDCs**") may use free writing prospectuses ("**FWPs**") in accordance with Rule 433 and certain other SEC advertising rules. (RILAs also may use FWPs, but since RILAs do not involve an investment company, the Rule 433 amendments do not apply to RILAs.)

2. The SEC amended Rule 433 in order to apply Rule 482(i) and (j) to closed-end funds and BDCs. As with amended Rule 482, the new Rule 433(c)(3) requirements apply if the FWP includes fee or expense information.

D. Amendments to Rule 34b-1

1. Rule 34b-1 applies to open-end and unit investment trust ("**UIT**") investment company supplemental sales literature (*i.e.*, sales literature that is preceded or accompanied by a prospectus) but not to RILA supplemental sales literature. Rule 34b-1 includes many of the same performance-related requirements found in Rule 482.

2. The Rule 34b-1(c) amendment incorporates Rule 482's requirements for required fee and expense figures if the supplemental literature includes fee and expense information.

E. Amendments to Rule 156

1. Rule 156 addresses factors to be considered in determining whether a particular statement involving a material fact is or might be misleading in investment company sales literature.

2. As amended, Rule 156(c)(1) provides that (i) any sales literature that contains fee and expense figures for a registered investment company or business development company must include the disclosure required by paragraph (i) of Rule 482, and (ii) any fee and expense information included in sales literature must meet the timeliness requirements of paragraph (j) of Rule 482.

3. Amended 156(c)(2) clarifies that the disclosure requirements of Rule 156(c)(1) do not apply to any quarterly, semi-annual, or annual report to shareholders under Section 30 of the 1940 Act or to other reports pursuant to Section 13 or Section 15(d) of the Exchange Act containing fee and expense information. The disclosure requirements of Rule 482(i) and (j) or Rule 433(c)(3) also do not apply to any such report containing fee and expense information.

III. RILA ADVERTISING PRINCIPLES

A. Supplemental Sales Literature

1. **Section 2(a)(10).** Section 2(a)(10) of the Securities Act defines the term "prospectus" to include any "prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security." Section (2)(a)(10)(a) also sets forth an exception from the definition of prospectus for "a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection 10(b) of this title) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication **a written prospectus meeting the requirements of**

subsection 10(a) of this title at the time of such communication was sent or given to the person to whom the communication was made."

2. **Rule 172 – Access Equals Delivery.** Rule 172 provides an "access equals delivery" prospectus delivery framework for Securities Act offerings that satisfy various conditions. Investment companies are excluded from Rule 172. The SEC observed in the RILA Form Proposing Release as follows:

> Insurance companies offering RILAs also are not required to deliver prospectuses to investors because they can rely on the Commission's "access equals delivery" framework in rule 172, although in practice we understand that insurance companies typically deliver prospectuses to accompany or precede other communications.[5]

3. **Section 10(a) Prospectus**. For purposes of satisfying requirements of supplemental sales literature, Rule 172 may not be relied upon to satisfy the obligation to send or give a Section 10(a) prospectus.

   a. In 2008, the SEC staff explains as follows:

> **Question**: Section 2(a)(10) of the Securities Act sets forth the definition of "prospectus." Clause (a) of Section 2(a)(10) provides an exception from the definition of "prospectus" for a communication that is sent or given after the effective date of the registration statement if "it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of Section 10 at the time of such communication was sent or given to the person to whom the communication was made." Is Rule 172 available to satisfy the condition to the exception in clause (a) of Section 2(a)(10) that the Section 10(a) prospectus be "sent or given to the person to whom the communication was made"?
>
> **Answer**: No. Rule 172 provides that a final Section 10(a) prospectus will be deemed to precede or accompany the carrying or delivery of a security for sale for purposes of Securities Act Section 5(b)(2) and provides a conditional exemption from Securities Act Section 5(b)(1) for written

[5] RILA Form Proposing Release, *supra* n.3, at 18.

> confirmations and notices of allocations. Rule 172 does not provide a means to satisfy the "sent or given" language in clause (a) of Section 2(a)(10). As the Commission stated in Securities Act Release No. 8591 (Jul. 19, 2005), in footnote 561, "a final prospectus only filed as provided in Rule 172 will not be considered to be sent or given prior to or with a written offer within the meaning of clause (a) of Securities Act Section 2(a)(10)."[6]

b. Moreover, the SEC has proposed amending Rule 172 to exclude RILAs from reliance on Rule 172, just as variable annuities are excluded:

> Therefore, we are excluding RILA offerings from rule 172 to ensure that investors receive a prospectus about these complex investments and because we are proposing to treat offerings of RILAs like offerings of variable annuities in other respects.[7]

4. **Ways to Send or Give a 10(a) Prospectus**. RILA issuers and distributors are at a disadvantage when it comes to providing a statutory prospectus for supplemental sales literature.[8]

   a. **Indication of how statutory prospectus may be obtained**. Rule 482 allows investment company sales literature and advertising to identify "a source from which an investor may obtain a prospectus." This means that, unlike RILAs, investment companies may use supplemental sales material without it being accompanied or preceded by a statutory prospectus. As discussed below, the RILA Form Adopting Release does not propose amending Rule 482 to include RILAs.

   b. **Hyperlinks**. The SEC and FINRA have permitted supplemental sales literature to include a hyperlink to a Section 10(a) prospectus. Hyperlinking to a statutory prospectus works well in electronic RILA

[6] SEC Division of Corporation Finance Compliance and Disclosures Interpretations, Question 110.1 (Nov. 26, 2008), *available at* https://www.sec.gov/corpfin/securities-act-sections.html.

[7] RILA Form Proposing Release, *supra* n.3, at 197.

[8] As discussed below, Rule 433 further divides types of issuers for FWP prospectus delivery requirements. A FWP used by a seasoned issuer or well-known seasoned issuer is not required to be preceded or accompanied by a statutory prospectus. On the other hand, a FWP used by a non-reporting and unseasoned issuer must be accompanied or preceded by a prospectus. Securities Act Rule 433(b)(1) & (b)(2)(i).

communications, but does not work for other communication forms such as radio, television, billboards, and the like.

c. **QR Codes**. As part of an advertisement communicated by mass media it may be possible to include a Quick Response code ("**QR code**") that sends the user to an issuer's website where a prospectus is available. On the website, an insurer could comply with the "sent or given" requirement by linking the Section 10 prospectus. The SEC has encouraged the use of QR codes in tailored shareholder reports and broker-dealer and investment adviser customer relationship summaries (Form CRS). As of the date of this outline, the SEC has not addressed the use of QR codes in RILA advertisements.

B. Rule 134 "Tombstone" Ads

1. Another exception from the definition of prospectus in Section 2(a)(10) or FWP in Rule 405 pertains to so-called tombstone ads containing limited items of information. Section 2(a)(10)(b) explains as follows:

> [A] notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of section [10(a)] of this title may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit.

2. Rule 134 sets forth items of information that may be contained in a 134 ad without the communication being deemed a prospectus. Items of information that may be included in a 134 ad include the following:

> (1) Factual information about the legal identity and business location of the issuer limited to the following: the name of the issuer of the security, the address, phone number, and e-mail address of the issuer's principal offices and contact for investors, the issuer's country of organization, and the geographic areas in which it conducts business;
>
> (2) The title of the security or securities; . . .

(8) The name, address, phone number, and e-mail address of the sender of the communication and the fact that it is participating, or expects to participate, in the distribution of the security;

(9) The type of underwriting, if then included in the disclosure in the prospectus that is part of the filed registration statement;

(10) The names of underwriters participating in the offering of the securities, and their additional roles, if any, within the underwriting syndicate; . . .

(12) A description of the procedures by which the underwriters will conduct the offering and the procedures for transactions in connection with the offering with the issuer or an underwriter or participating dealer (including procedures regarding account-opening and submitting indications of interest and conditional offers to buy), and procedures regarding directed share plans and other participation in offerings by officers, directors, and employees of the issuer;

(13) Whether, in the opinion of counsel, the security is a legal investment for savings banks, fiduciaries, insurance companies, or similar investors under the laws of any State or Territory or the District of Columbia, and the permissibility or status of the investment under the Employee Retirement Income Security Act of 1974 [29 U.S.C. 1001 et seq.];

(14) Whether, in the opinion of counsel, the security is exempt from specified taxes, or the extent to which the issuer has agreed to pay any tax with respect to the security or measured by the income therefrom; . . .

(16) Any statement or legend required by any state law or administrative authority; . . . and

(22) Information disclosed in order to correct inaccuracies previously contained in a communication permissibly made pursuant to this section.

3. Even though Rule 134 limits the items of information that may be contained in the communication, the requirement in Rule 134 to offer a 10(a) prospectus

can be satisfied in more ways than the prospectus delivery predicate requirements of Section 2(a)(10), as follows:

a. "[S]tate from whom and include the uniform resource locator (URL) where a written prospectus meeting the requirements of section 10 of the Act (other than a free writing prospectus as defined in Rule 405) may be obtained, . . .; or

b. [the Rule 134 communication must be] accompanied or preceded by a prospectus or a summary prospectus, other than a free writing prospectus as defined in Rule 405, which meets the requirements of section 10 of the Act."

4. Since Rule 134 ads are excepted from the definition of prospectus, they are not subject to prospectus liability under Section 12(a)(2) of the Securities Act for false or misleading statements of material fact. Section 12(a)(2) imposes liability on persons who offer or sell a security in interstate commerce by means of a prospectus or oral communication which includes an untrue statement of material fact, or omits to state a material fact that is necessary under the circumstances in order to make the statements made not misleading, subject to a defense that the offeror/seller did not know and, in the exercise of reasonable care, could not have known, of the untruth or omission.

C. Rule 433 Free Writing Prospectus

1. Pursuant to Rule 433, a FWP that satisfies the conditions of Rule 433 may include information, the substance of which is not included in the registration statement. Rule 433 further provides that a FWP that satisfies the conditions of Rule 433 will be deemed a prospectus permitted under 10(b) for purposes of Sections 2(a)(10), 5(b)(1), and 5(b)(2) of the Securities Act, provided a Rule 430 preliminary prospectus or Section 10(a) statutory prospectus has been filed.

2. As noted above, for non-reporting and unseasoned issuers, the FWP must be accompanied or preceded by the most recent statutory prospectus (or red herring prospectus during the waiting period). Seasoned and well-known seasoned issuers may use a FWP that is not accompanied or preceded by a prospectus.

D. Proposed Amendments to Rule 156

1. The RILA Form Proposing Release addresses Rules 156 and 482 under the Securities Act in the context of RILAs and requests comment on the proposed

application of Rule 156 to RILAs and on the SEC's proposal not to amend Rule 482 to include RILAs.[9]

2. The RILA Form Proposing Release would require RILA issuers to comply with Rule 156, entitled "Investment company sales literature." Rule 156 provides guidance as to when investment company sales literature is materially misleading under the federal securities laws.

3. As the SEC explains in the RILA Form Proposing Release:

> Rule 156 does not prohibit or permit any particular representations or presentation, rather it is an interpretive rule that provides factors to be weighed in considering whether a statement involving a material fact is or might be misleading in the specific context of investment company sales literature for purposes of the federal securities laws, including sales literature relating to the sale of variable annuities. Applying this rule to RILA sales literature is consistent with the RILA Act in that it would provide RILA issuers guidance on ways to avoid presenting investors with materially misleading advertisements, which should help ensure that investors receive the information necessary to make informed decisions about these products. *Id.* at 198.

4. In proposing amendments to Rule 156, the SEC staff reviewed RILA sales literature. *Id.* at 199. In this regard, the RILA Form Proposing Release provides examples of how RILA sales literature could be misleading "without adequately explaining [] limitations or the insurer's discretion to alter key features," as follows:

   a. "[I]f rule 156 were applied to RILAs as proposed, rule 156 would assist insurance companies in considering whether representations about a RILA as **a growth product** would require qualification in light of particular RILA features, such as the existence and extent of any limitations on upside index performance."

   b. "Representations that highlight **downside protections** of a RILA could similarly be misleading without the context of the cost or limitation of those protections (*e.g.,* upside limitations)."

   c. "The same analysis would apply to representations that tout **customization** without discussing the trade-offs associated with that customization (*e.g.*, long lock-up periods to get the best rates or having to experience a contract adjustment when making a change), or fail to

[9] RILA Form Proposing Release, supra n.3, at 204-205.

explain that the insurance company has reserved the **right to change or remove key features** of the contract while surrender charges still apply."

d. "[R]equire an insurance company to consider whether an advertisement would be materially misleading if it suggests a given RILA is a **loss-avoidance vehicle or a customizable product** in the absence of qualifying explanations or statements."

e. "Similarly, if sales literature advertises a particular feature of the product's bounded return structure (including, *e.g.*, a specified index; an upside feature such as a particular 'cap rate' or 'participation rate'; or a downside feature such as a 'floor' or 'buffer') that is **not available for the life of the product** or the full term of any surrender charge period, the rule would require consideration of whether the statement is misleading without providing additional context as to the insurer's discretion."

f. "[R]equire consideration about whether representations or portrayals either of a **RILA's costs or charges** (*e.g.,* advertising implying that a RILA had low costs or no ongoing charges), or **optional benefits** that are subject to a contract adjustment, would necessitate qualifying statements or explanations regarding the costs or tradeoffs to the investor to receive an advertised benefit or those generally associated with the RILA."

g. "[R]equire consideration of whether **illustrations** about the operation of a RILA or its features could be misleading because, for example, they use **assumptions** (such as limits on gains or index performance that includes dividends whereas the RILA's index does not include dividends) that are not currently offered or exceed what could be reasonably anticipated or use 'cherry picked' data. Including **historical index performance in an advertisement** also would mislead investors if, for example, it suggested that the performance shown is predictive of future performance of the index or a RILA. On the other hand, using the **index's historical performance** to illustrate how a RILA works in a fair and balanced way (*e.g.,* by showing index performance relative to representative limits on gains and losses, as some RILA advertisements currently do) would be consistent with the proposed extension of rule 156 to RILA advertisements, assuming those advertisements otherwise include appropriate caveats to ensure that the illustrations are not misleading." *Id.* at 199-202 (emphasis added).

5. The RILA Form Proposing Release states that showing historical RILA performance or historical index-linked option would be **materially misleading**, as follows:

> Moreover, our preliminary view is that purporting to show the historical *performance of the RILA or any particular index-linked option itself* would generally be materially misleading. This is because the terms of a RILA investment, such as limits on gains, change frequently, making past performance irrelevant to current investors who are not able to utilize those past rates in current market conditions. In addition, to the extent that a RILA is using a point-to-point crediting method, that RILA's return to an investor would be particularly sensitive to the specific date the investor purchased the RILA and when the crediting period ends for the index-linked option chosen by the investor." *Id.* at 202 (emphasis in original).

E. <u>RILA Form Proposing Release Consideration of Rule 482</u>

1. The RILA Form Proposing Release notes that the SEC considered amending Rule 482 to include RILAs. Rule 482 applies to investment company advertisements and allows an ad to include performance information under standardized formulas as well as non-standardized performance that is accompanied by standardized performance. A Rule 482 ad is an "omitting prospectus" and the rule does not require that the communication be accompanied or preceded by a statutory prospectus.

2. In deciding not to amend Rule 482 to include RILAs, the RILA Form Proposing Release notes as follows:

> As explained below, we have not yet seen sufficient evidence to support an expansion of rule 482 to RILAs at this time, though we acknowledge such concerns may develop in the future. This conclusion largely follows from the rule's **standardized performance data requirements**, which do not align with current practices in RILA advertisements. . . . RILA advertising also typically does not attempt to utilize past performance, suggesting there is neither a need for rules prescribing RILA-specific past performance metrics, nor sufficient experience to inform the development of such metrics. For these reasons, we would not change rule 482 to include RILAs. *Id.* at 203 (internal footnotes omitted; emphasis added).

3. Apart from pinpointing performance requirements as the purported reason not to amend Rule 482 to include RILAs, the SEC acknowledges disparate treatment of RILAs vis-à-vis providing a prospectus, as follows:

> Unlike the rules applicable to most RILAs, rule 482 also permits registered investment companies and business development companies to provide advertisements and sales literature to investors without it being accompanied or preceded by a statutory prospectus. *Id.* at 203.

4. Also, in deciding not to amend Rule 482 to include RILAs, the RILA Form Proposing Release notes that RILA sales literature would be **subject to Rule 433** under the Securities Act, as follows:

> As a result, RILA sales literature, as "free writing" prospectuses, would continue to be subject to [Rule 164] and [Rule 433], **as well as any other applicable rule** that permits a communication notwithstanding the 'gun jumping' provisions of the Securities Act. *Id.* at n.356 (emphasis added).

5. Rule 433 is of little help to non-reporting and unseasoned RILA issuers because their FWPs must be accompanied or preceded by a statutory prospectus. On the other hand, similar to Rule 482 ads, reporting and well-known seasoned issuers may use a FWP that is not accompanied or preceded by a statutory prospectus.

IV. OFF-CHANNEL COMMUNICATIONS

A. Background

1. For a number of years the SEC and FINRA have cautioned broker-dealers and investment advisers about problematic record-keeping practices involving the use of texting, messaging, and social media applications — such as WhatsApp, WeChat, Facebook, and Slack — for business-related communication.[10]

[10] For example, FINRA's 2017 Regulatory and Examination Priorities Letter (Jan 4, 2017) provides as follows:

> **Social Media and Electronic Communications Retention and Supervision**
> FINRA will review firms' compliance with their supervisory and record-retention obligations with respect to social media and other electronic communications in light of the increasingly important role they play in the securities business. We note that these obligations apply to business communications irrespective of the medium or device used to communicate. Under U.S. Securities and Exchange Commission (SEC) and FINRA record-retention requirements, firms must ensure the capture of business-related communications regardless of the devices or networks used. A firm must capture and maintain all business-related communications in such a way that the firm can review them for inappropriate business conduct.

2. In 2017, FINRA provides guidance on how FINRA and SEC recordkeeping rules applied to digital communications "in light of emerging technologies and communications innovations." *Social Media and Digital Communications*, FINRA Regulatory Notice 17-18 (April 2017), *available at* https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-18.pdf.

3. In 2018, the SEC reports examination observations about the use of electronic messaging by investment advisers. *SEC National Exam Program Risk Alert* (Dec. 14, 2018) ("The purpose of this Risk Alert is to remind advisers of their obligations when their personnel use electronic messaging and to help advisers improve their systems, policies, and procedures by sharing the staff's observations from these examinations."), *available at* https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Electronic%20Messaging.pdf.

4. In 2019, FINRA examinations uncover that some broker-dealers did not maintain a process to reasonably identify and respond to "red flags that registered representatives were using impermissible personal digital channel communications in connection with firm business." *2019 Report on FINRA Examinations and Findings* (Oct. 16, 2019), *available at* https://www.finra.org/sites/default/files/2019-10/2019-exam-findings-and-observations.pdf.

5. In 2021, the SEC Division of Enforcement commences an initiative to investigate record preservation practices at financial firms. The Division requests off-channel communications data from a sampling of approximately 30 broker-dealer personnel at various levels of seniority over an almost four-year period from January 2018 through September 2021. The Division encourages firms whose record preservation practices do not comply with the securities laws to contact the SEC.

B. Enforcement Actions

1. In December 2021, the SEC announces a settled enforcement action against a broker-dealer for "widespread and longstanding failures by the firm and its employees to maintain and preserve written communications." The SEC imposes a penalty of $125 million and commences additional investigations. https://www.sec.gov/news/press-release/2021-262.

2017 Regulatory and Examination Priorities Letter (Jan. 4, 2017), *available at* https://www.finra.org/rules-guidance/communications-firms/2017-exam-priorities; *see also 2019 Report on FINRA Examination Findings and Observations* (Oct. 2019), *available at* https://www.finra.org/sites/default/files/2019-10/2019-exam-findings-and-observations.pdf.

2. SEC, FINRA, and CFTC enforcement actions involving off-channel communications are identified in the below chart. Regulatory fines involving recordkeeping violations by broker-dealers, investment advisers, and futures commission merchants and their personnel have exceeded $1.5 billion.

DATE	REGULATOR / ACTION	PENALTIES / NOTES
Dec. 17, 2021	SEC J.P. Morgan Securities LLC (JPMS), a broker-dealer subsidiary of JPMorgan Chase & Co., for widespread and longstanding failures by the firm and its employees to maintain and preserve written communications	$125 million https://www.sec.gov/news/press-release/2021-262 "As a result of the findings in this investigation, the SEC has commenced additional investigations of record preservation practices at financial firms. Firms that believe that their record preservation practices do not comply with the securities laws are encouraged to contact the SEC at BDRecordsPreservation@sec.gov."
Dec. 2021	CFTC Orders JPMorgan to Pay $75 million for widespread Use by employees of unapproved communication methods and related recordkeeping and supervision failures	$75 million https://www.cftc.gov/PressRoom/PressReleases/8470-21
Sept. 16, 2022	FINRA H.C. Wainwright & Co, et al. -- between September 2017 and September 2020, H.C. Wainwright "**failed to preserve and reasonably supervise its employees' business-related text messages**." AWC[11]	$1,500,000 – firm $15,000 fine and 60 day suspension – 2 individuals "While the firm's written supervisory procedures (WSPs) prohibited employees from using text messaging for business-related communications, and the firm's compliance department discussed this prohibition with employees several times each year, the firm's management knew that firm employees were using text messaging for business-related communications, because they themselves were texting each other and others about firm business."
Sept. 27, 2022	SEC Sanctioned 15 broker-dealers and one affiliated RIA for widespread recordkeeping	$1.1 billion

[11] https://www.finra.org/sites/default/files/fda_documents/2017055977301%20H.C.%20Wainwright%20%26%20Co.%2C%20LLC%20CRD%20375%20John%20Wesley%20Chambers%20CRD%201863864%20Robert%20Eugene%20Kristal%20CRD%204269940%20AWC%20va.pdf.

DATE	REGULATOR / ACTION	PENALTIES / NOTES
	violations of Section 17(a)(1) of the Exchange Act and Rule 17a-4(b)(4) thereunder resulting from the firms' failure to maintain and preserve electronic communications	
Sept. 27, 2022	CFTC Orders 11 financial institutions to pay over $710 million for recordkeeping and supervision failures for widespread use of unapproved communication methods	$710 Million "The Commodity Futures Trading Commission today issued orders simultaneously filing and settling charges against swap dealer and futures commission merchant (FCM) affiliates of 11 financial institutions for failing to maintain, preserve, or produce records that were required to be kept under CFTC recordkeeping requirements, and failing to diligently supervise matters related to their businesses as CFTC registrants." https://www.cftc.gov/PressRoom/PressReleases/8599-22
Sept. 27, 2022	SEC Certain broker-dealers	https://www.sec.gov/files/rules/other/2022/33-11109.pdf
Oct. 24, 2022	FINRA Dennis David Karjala AWC[12]	$10,000 and three month suspension "In addition, Respondent made these statements to the customer using text messages via his personal cell phone, rather than a firm-approved application. As a result, the communications were not preserved as required by Section 17(a) of the [Exchange Act] and Rule 17a-4(b)(4) thereunder. By causing LPL to maintain incomplete books and records, Respondent violated FINRA Rules 4511 and 2010."
Nov. 11, 2022	FINRA Hinman Au AWC[13]	$20,000 (includes other violations) and 45 day plus 18 month suspension "from November 2018 to August 2019, Respondent used an instant messaging service, WeChat, and a personal email account to send and receive securities-related business communications without providing copies to the firm. Respondent thereby prevented the firm from

[12] https://www.finra.org/sites/default/files/fda_documents/202102708801%20Dennis%20David%20Karjala%20CRD%205918770%20AWC%20va%20%282022-1669249207149%29.pdf.

[13] https://www.finra.org/sites/default/files/fda_documents/2019062623003%20Hinman%20Au%20CRD%2022434662%20AWC%20lp%20%282022-1670804406257%29.pdf.

DATE	REGULATOR / ACTION	PENALTIES / NOTES
		preserving the communications, as required by Section 17(a) of the Securities Exchange Act of 1934 (the Exchange Act) and Rule 17a-4(b)(4) thereunder. By causing the firm to maintain incomplete books and records, Respondent violated FINRA Rules 4511 and 2010."
Jan. 9, 2023	FINRA Deloitte Corporate Finance, LLC AWC[14]	$200,000 fine and censure "Between July 2017 and February 2022, DCF failed to retain business-related iMessages sent and received by its representatives on 95 firm-owned Apple iPhones, in violation of Section 17(a) of the [Exchange Act], Rule 17a-4 of the Exchange Act, and FINRA Rules 4511 and 2010" "DCF established a system to prevent the use of iMessages but failed to deploy it successfully on all firm-owned iPhones." "In resolving this matter, FINRA has recognized DCF's **extraordinary cooperation**. The firm discovered the iMessage issue through its own compliance reviews. . . "
May 11, 2023	SEC Charged HSBC Securities (USA) Inc. and Scotia Capital (USA) Inc. for widespread and longstanding failures by both firms and their employees to maintain and preserve electronic communications	$22.5 Million https://www.sec.gov/news/press-release/2023-91 "Both HSBC and Scotia Capital self-reported and self-remediated their recordkeeping violations, and the reduced penalties in these cases reflect their efforts and cooperation."
May 11, 2023	CFTC An order simultaneously filing and settling charges against The Bank of Nova Scotia, a provisionally registered swap dealer and Scotia Capital USA Inc., a futures commission merchant, (collectively BNS Affiliates)	$15 million https://www.cftc.gov/PressRoom/PressReleases/8699-23 "The order charges BNS Affiliates with failing to maintain, preserve, or produce records that were required to be kept under CFTC recordkeeping requirements, and failing to diligently supervise matters related to their businesses as CFTC registrants."

[14] https://www.finra.org/sites/default/files/fda_documents/2022074183401%20Deloitte%20Corporate%20Finance%2C%20LLC%20CRD%20111747%20AWC%20va%20%282023-1675902013480%29.pdf.

DATE	REGULATOR / ACTION	PENALTIES / NOTES
May 11, 2023	SEC Certain broker-dealers	https://www.sec.gov/files/rules/other/2023/33-11182.pdf
June 1, 2023	FINRA AWC [15] -- Delaina Kucish, a former Edward D. Jones & Co., L.P. ("Edward Jones") broker for the use of text messages on a personal cell phone to transmit client documents to another individual at the firm	$15,000 fine and 15 month suspension from associating with any FINRA member in all capacities "By causing Edward Jones to fail to preserve required books and records, Kucish violated FINRA Rules 4511 and 2010."
July 7, 2023	FINRA John James Hoidas FINRA alleged that Hoidas violated FINRA Rules 4511 and 2010	$40,000 fine and an 18-month suspension from associating with any FINRA member in all capacities (fine includes other violations) "Nonetheless, from at least March 2017 to July 2019, while registered through UPS, Hoidas communicated with UPS customers through text messages using his personal phone regarding securities-related business. These communications included the solicitation of investments and discussions of investment strategies. Because text messaging was not an approved electronic communications channel, however, UPS did not capture or maintain Hoidas's text message communications, which it was required to do under Exchange Act Rule 17a-4(b)(4)."
Aug. 8, 2023	SEC Charges against 10 firms in their capacity as broker-dealers and one dually registered broker-dealer and investment adviser for widespread and longstanding failures by the firms and their employees to maintain and preserve electronic communications	$289 million https://www.sec.gov/news/press-release/2023-149
Aug. 8, 2023	CFTC Orders simultaneously filing and settling charges against	$260 million https://www.cftc.gov/PressRoom/PressReleases/8762-23

[15] https://www.finra.org/sites/default/files/fda_documents/2021072548702%20Delaina%20Kucish%20CRD%2044001092%20AWC%20lp.pdf.

DATE	REGULATOR / ACTION	PENALTIES / NOTES
	swap dealer and futures commission merchant (FCM) affiliates of four financial institutions for failing to maintain, preserve, or produce records that were required to be kept under CFTC recordkeeping requirements, and failing to diligently supervise matters related to their businesses as CFTC registrants	
Sept. 29, 2023	SEC Charges against five broker-dealers, three dually registered broker-dealers and investment advisers, and two affiliated investment advisers for widespread and longstanding failures to maintain and preserve electronic communications	$79 million https://www.sec.gov/news/press-release/2023-212 "The firms admitted the facts set forth in their respective SEC orders and acknowledged that their conduct violated recordkeeping provisions of the federal securities laws. The firms agreed to pay combined penalties of $79 million and have begun implementing improvements to their compliance policies and procedures to address these violations."
Sept 29, 2023	CFTC charges against an introducing broker, and a futures commission merchant, for failing to maintain and preserve records that were required to be kept under CFTC recordkeeping requirements, and failing to diligently supervise matters related to their businesses as CFTC registrants	$20 million https://www.cftc.gov/PressRoom/PressReleases/8550-22

C. FINRA Off-Channel Communication Guidance to Firms

1. **Effective Practices** – In the *2023 Report on FINRA's Examination and Risk Monitoring Program* ("**2023 FINRA Exam Priorities Report**"), FINRA reports effective practices for retaining digital communications, as follows:

a. **Contract Review**: Reviewing vendors' contracts and agreements to assess whether firms will be able to comply with the recordkeeping requirements.

b. **Testing and Verification**: Testing recordkeeping vendors' capabilities to fulfill regulatory obligations by, for example, simulating a regulator's examinations by requesting records and engaging regulatory or compliance consultants to confirm compliance with the recordkeeping requirements

2. **Questions to Ask**. The 2023 FINRA Exam Priorities Report also provides a list of questions firms can ask related to their digital communication channels. The questions are designed to assist firms in evaluating their digital communication channel policies and procedures, as follows:

- Does your firm's digital communication policy address all permitted and prohibited digital communication channels and features available to your customers and associated persons, including:

  - procedures and controls to retain all correspondence by staff conducting firm business via third party digital communications channels;
  - processes and procedures to monitor for new communications methods available to customers and associated persons; and
  - training and guidance your firm's associated persons have to complete before they are permitted access to firm-approved communication channels?

- Does your firm review for red flags that may indicate a registered representative is If your firm emails its clients and customers links to Virtual Data Rooms (VDRs)—online data repositories that secure and distribute confidential information—does your firm retain and store documents embedded in those links once the VDRs are closed?

- If your firm is converting paper records to electronic records, does it maintain procedures and controls to verify the conversion process (i.e., comparing electronic and original records) to confirm that the electronic records are accurate, complete and readable?[16]

[16] *2023 Report on FINRA's Examination and Risk Monitoring Program* (Jan. 10, 2023) at 40, available at https://www.finra.org/sites/default/files/2023-01/2023-report-finras-examination-risk-monitoring-program.pdf.

D. Investment Adviser Recordkeeping Requirements

1. On January 31, 2023, ten financial industry trade associations, including SIFMA and the ICI, wrote to Chair Gensler to express concern about the SEC's off-channel communication regulatory overreach with regard investment advisers.

2. The letter notes, "we are strongly concerned that the SEC is **attempting to exceed its authority under the Advisers Act** and engaging in rulemaking by enforcement through its current sweep regarding off-channel communications. The letter makes clear that "Investment Advisers are not required to preserve all business communications."[17] (emphasis added.)

3. The trade association letter explains as follows: "Advisers Act Rule 204-2(a)(7) requires registered investment advisers to maintain **four narrow enumerated categories of written communications**; specifically, communications 'received and . . . sent by such investment adviser' relating to (i) recommendations made or proposed to be made and advice given or proposed to be given; (ii) receipt, disbursement or delivery of funds or securities; (iii) placing or execution of orders to purchase or sell securities; and (iv) predecessor performance." *Id.*

E. SEC 2023 Examination Priority

1. The SEC's examination of off-channel communication practices continues. *See* 2023 SEC examination priorities (Feb. 7, 2023). https://www.sec.gov/files/2023-exam-priorities.pdf

2. The SEC press release announcing the 2023 priorities notes, as follows:

> This year, the Division intends to focus examinations on broker-dealer compliance and supervisory programs generally, including those for electronic communications related to firm business, as well as the recordkeeping for those electronic communications. https://www.sec.gov/news/press-release/2023-24

F. Credit for Cooperation and Independent Compliance Consultants

1. In bringing charges against broker-dealers (and some investment advisers) for alleged violations of certain recordkeeping provisions of the Exchange Act and with "failing to reasonably supervise with a view to preventing and detecting those violations," the SEC staff has encouraged broker-dealers to

[17] https://www.sifma.org/wp-content/uploads/2023/02/Investment-Adviser-Recordkeeping-Requirements.pdf.

self-report violations and cooperate in the SEC staff investigations. Several of the settled actions state that credit was given for extraordinary cooperation. In a recent press release, Gurbir S. Grewal, Director of the SEC's Division of Enforcement, notes "There are real benefits to self-reporting, remediating and cooperating."[18]

2. The SEC enforcement orders also require the firms to retain independent compliance consultants to, among other things, "conduct comprehensive reviews of their policies and procedures relating to the retention of electronic communications found on personal devices and their respective frameworks for addressing non-compliance by their employees with those policies and procedures." *Id.*

V. CONCLUSION

The SEC adopted amendments to the investment company advertising rules in 2022 and proposed additional amendments to the advertising rules in September 2023. It is not yet clear what form the 2023 proposed amendments will take. For RILA issuers, however, without the ability to use an "omitting prospectus," the proposed amendments may not go far enough for RILAs to advertise in the same ways variable annuities advertise. Finally, for broker-dealers and investment advisers, the recent SEC, CFTC, and FINRA settled enforcement actions on off-channel communications send a signal to review, and if necessary, revise, the firm's current digital communication and recordkeeping policies and procedures.

A.B.F.
10/20/23

[18] SEC Press Release 2023-212, *SEC Charges 10 Firms with Widespread Recordkeeping Failures* (Sept. 29, 2023), *available at* https://www.sec.gov/news/press-release/2023-212.