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FINRA Requests Comment on Proposed Amendments to Rules Governing Communications with the Public

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Introduction

On February 10, 2017, the Financial Industry Regulatory Authority, Inc. ("**FINRA**") requested comments on proposed amendments to Rule 2210 (Communications with the Public) to allow performance projections in investment planning presentations, subject to certain conditions discussed below.[1]

Background

Performance projections are generally prohibited under FINRA rules. Specifically, FINRA Rule 2210(d)(1)(F) prohibits member firms from predicting or projecting performance, implying that past performance will recur, or making any exaggerated or unwarranted claim, opinion, or forecast. This prohibition is primarily intended to protect retail investors from performance projections of individual investments, which in FINRA's view may be inaccurate or otherwise misleading. In response to comments received from member firms and other interested parties in connection with FINRA's retrospective review of Rule 2210 ("**Retrospective Review**"),[2] FINRA is now proposing amendments to Rule 2210 that would permit member firms to include the projected performance of an asset allocation or other investment strategy, but not of any individual security, in a customized hypothetical investment planning illustration ("**Customized Projections**").

The comment period for the rule proposal expires on March 27, 2017.

The Rule Proposal

In proposing these amendments, FINRA recognized that communications with the public that include Customized Projections could better inform investors about the recommended strategies, including the assumptions and risks upon which the strategies are based. Moreover, FINRA noted that Customized Projections are not prohibited in investment adviser advertisements, as long as they comply with the anti-fraud provisions of §206(4) of the Investment Advisers Act of 1940, as amended. Accordingly, FINRA is proposing amendments to Rule 2210 that would allow member firms to include a Customized Projection in a communication with the public under the following conditions: [1] the illustration projects performance of an asset allocation or other investment strategy and not an individual security; [2] a reasonable basis exists for all assumptions, conclusions, and

[1] See FINRA Regulatory Notice 17-06 (February 10, 2017).
[2] See Communications with the Public Retrospective Rule Review Report (December 2014).

recommendations upon which the Customized Projection is based;[3] and [3] the presentation of the Customized Projection is accompanied by clear and prominent disclosure of all material assumptions and limitations applicable to the Customized Projection, that it is hypothetical, and that there are no guarantees that any described scenario or event will actually occur. Any communications with the public including a Customized Projection would be subject to FINRA's supervisory requirements regarding registered principal review and approval of any template (or specific illustration if no template is used) before use or distribution.

Analysis and Interpretation

In recent years and largely in response to comments received from member firms and other interested parties in connection with the Retrospective Review, FINRA has taken significant steps towards harmonizing FINRA and Securities and Exchange Commission advertising standards. Specifically, FINRA has issued interpretive relief: [1] stating its view that "related performance" may be used in certain communications related to registered open-end investment companies;[4] and [2] permitting the use of pre-inception index performance data in communications related to exchange traded products.[5] This rule proposal is an important next step that member firms should consider closely. FINRA has invited comment on: [1] direct or indirect costs, benefits and magnitude of the amendments to member firms and investors; [2] impact to dually-registered firms with customers that do not have investment advisory accounts and are currently not able to receive projections-related communications and extent to which these firms anticipate utilizing the proposed exception; [3] extent to which dually-registered firms will align the performance projections in their investment advisory services to the proposed amendments; and [4] other alternative approaches FINRA should consider to accomplish the goals described in the proposal.

Next Steps and How We Can Help

The proposed rule change would provide important relief to dually-registered member firms that provide financial planning products and services to their retail clients. K&L Gates intends to submit a comment letter to FINRA to address certain aspects of the proposal.

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[3] Reasonableness, in turn, must be based on a number of factors, such as historical performance and performance volatility of asset classes, fixed income investment duration, the impact of fees, costs and taxes and other macroeconomic factors.

[4] See FINRA Interpretive Letter to Edward P. Macdonald, Hartford Funds Distributors, LLC (May 12, 2015).

[5] See FINRA Interpretive Letter to Bradley J. Swenson, ALPS Distributors, Inc. (April 22, 2013).

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