

# Chapman Client Alert

February 15, 2017

Current Issues Relevant to Our Clients

## FINRA Proposes Allowing Limited Customized Hypothetical Performance Projections

The Financial Industry Regulatory Authority, Inc. (“*FINRA*”) recently proposed amendments that would create a new exception to *FINRA*’s prohibition on projecting performance. The proposed exception to *FINRA* Rule 2210 would permit a firm to distribute a customized hypothetical investment planning illustration that includes the projected performance of an asset allocation or other investment strategy subject to specified conditions. The proposal would not permit performance projections of individual securities. *FINRA*’s proposal is available [here](#). You can submit comments on the proposal through March 27, 2017.

### Background

*FINRA* Rule 2210 currently provides that communications cannot predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. This prohibition currently only provides exceptions for hypothetical illustrations of mathematical principles, investment analysis tools, price targets in research reports and certain projections concerning security futures and options. As part of a 2014 retrospective review of Rule 2210, *FINRA* received comments suggesting that investors could benefit from projections in the limited context of asset allocations and other investment strategies that do not project the performance of individual securities. Commenters noted that the Investment Advisers Act of 1940 (the “*Advisers Act*”) does not prohibit the presentation of projections that comply with the *Advisers Act*’s antifraud provisions.

### Proposed Amendments to Rule 2210

#### Exception for Customized Hypothetical Investment Planning Illustrations

*FINRA* is proposing an exception to the prohibition on predicting or projecting performance for any customized hypothetical investment planning illustration that projects performance of an asset allocation or other investment strategy, and not an individual security, where:

- there is a reasonable basis for all assumptions, conclusions and recommendations, and
- the illustration clearly and prominently discloses
  - that the illustration is hypothetical,
  - that there is no assurance that any described investment performance or event will occur, and
  - all material assumptions and limitations to the illustration.

The rule proposal describes a “customized” investment planning illustration as one designed for a particular client or multiple clients who share an account. The proposal provides examples of how a “reasonable basis” might be established including by reference to:

- the historical performance and performance volatility of asset classes,
- the curation 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 the customer.

However, the proposal notes that an unreasonable emphasis on any one factor may cause a projection to be noncompliant. It also notes that basing a projection on hypothetical back-tested performance or the past performance of particular investments by an asset manager would not be reasonable.

### Supervisory Requirements for Permitted Illustrations

The proposal also provides specific supervisory requirements for any permitted customized hypothetical investment planning illustration. Firms would either need to require a registered principal to:

- review and approve each investment planning illustration before use or distribution, or
- review and approve each template for investment planning illustrations before use or distribution and then supervise and review the actual investment planning illustrations in the same manner required for correspondence under Rule 3110 (Supervision).

Firms would not be required to file these communications with FINRA for review.

### What's Next?

You can submit comments to FINRA by email to [pubcom@finra.org](mailto:pubcom@finra.org) or by mail through March 27, 2017. Prior to the amendments becoming effective, FINRA would need to complete the comment process, have the proposal approved for filing with the Securities and Exchange Commission ("SEC") by the FINRA Board of Governors and complete the filing and notice process with the SEC.

### For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at [chapman.com](http://chapman.com).

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