
Investment Adviser Advertising Rule: New SEC Guidance and Best Practices for Compliance

TUESDAY, NOVEMBER 21, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Michael K. Renetzky, Partner, **Locke Lord**, Chicago

Tom Bohac, **Locke Lord**, Chicago

Matthew J. Kutner, **Morrison & Foerster**, New York

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10.**

Tips for Optimal Quality

FOR LIVE EVENT ONLY

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-888-450-9970** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 35.

Program Materials

FOR LIVE EVENT ONLY

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Most Frequent Advertising Rule Compliance Issues for 2017



Michael Renetzky
Tom Bohac

MORRISON
FOERSTER

Matthew Kutner

Rule 206(4)-1

- Defines fraudulent, deceptive and manipulative advertising practices for RIAs.
- Applies to all communications and publications (notably most written, radio and television) which offer:
 - any analysis, report or publication concerning securities;
 - any graph, chart, formula, or other device to be used in making any determination whether to buy or sell securities; or
 - any other investment advisory service with respect to securities.
- Note; however, that a written communication by an Adviser that does no more than respond to an unsolicited request by a client, prospective client, or consultant is not an “advertisement” under the Advertising Rule. (Investment Counsel Ass’n of America, Inc. No Action Letter March 1, 2004)

Rule 206(4)-1(a)

- It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act for any investment adviser registered or required to be registered under section 203 of the Act, directly or indirectly, to publish, circulate, or distribute any advertisement:
 - (1) Which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser; or
 - (2) Which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person: Provided, however, That this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately: (i) State the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (ii) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: “it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list”; or
 - (3) Which represents, directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making his own decisions as to which securities to buy, sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or
 - (4) Which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or
 - (5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading.

Rule 206(4)-1(b)

- For the purposes of this section the term advertisement shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.

Compliance Issues Overview

- Common Deficiencies
 - Misleading performance results
 - Misleading one-on-one presentations
 - Misleading claim of compliance with voluntary performance standards
 - Cherry picking
 - Misleading presentation of select recommendations
 - Inadequate policies and Procedures
- Focus on SEC's recent "Touting Initiative"
 - Addressing the adequacy of disclosures made by investment advisers when listing awards, rankings, and professional designations in marketing materials.

Most Frequent Advertising Rule Compliance Issues

- **Misleading Performance Results**
 - Presented performance results gross of fees, without adequate disclosure.
 - Compared results to a benchmark but did not include disclosures about limitations of the comparisons, including differences in the strategies.
 - Included hypothetical and back-tested performance results, without adequate disclosures.
 - *Ex. F-Squared*

Most Frequent Advertising Rule Compliance Issues

- **Misleading One-on-One Presentations.**
 - Used gross of fees performance results in certain one-on-one presentations, without adequate disclosures.
 - Failed to disclose that performance results did not reflect advisory fee deductions.

Sample Gross of Fees Disclosure

- **Performance is presented gross of fees.** The above performance information does not reflect the deduction of advisory fees or other fund expenses. As such, your return will be reduced by our advisory fees and any other expenses incurred in the management of your account, such as brokerage fees. Please see our Form ADV Part 2A for additional detail regarding our advisory fees, including for an example of the effect that the advisory fees could have on the overall return of your account.

Most Frequent Advertising Rule Compliance Issues

- **Misleading Claim of Compliance with Voluntary Performance Standards.**
 - Claimed that their performance results complied with a voluntary performance standard when compliance with standard guidelines was unclear.
 - For instance, claims of GIPS compliance when such claims cannot be validated.
 - Note that if an Adviser claims GIPS compliance, GIPS always applies to the Adviser, unless appropriate disclosures are made.
 - Though not required, many Advisers employ an external firm to verify compliance with GIPS.
 - No typical amount of GIPS review during an SEC exam, the examiners may not touch on GIPS or may take a deep dive.

Most Frequent Advertising Rule Compliance Issues

- **Cherry-Picked Profitable Stock Selections.**
 - Included only profitable stock selections in presentations, newsletters, or websites, without proper supplemental information.
 - Presenting recommendations so as to create the appearance of overall profitable stock selection.

Most Frequent Advertising Rule Compliance Issues

- **Misleading Selection of Recommendations.**
 - Disclosed only certain past specific investment recommendations to illustrate a particular investment strategy.
 - *Best Practices regarding presentation of specific recommendations:*
 - Advertising past specific recommendations that were selected using consistently applied, objective, non-performance based selection criteria.
 - See Franklin Management, Inc. No Action Letter (December 10, 1998)
 - Retain a support file to backup any selection criteria used.
 - Advertising the five (or more) best performing holdings along with an equal number of worst performers.
 - See TCW Group No Action Letter (November 7, 2008).
 - A written communication by an Adviser to its existing clients generally would not be an advertisement within the Advertising Rule merely because it discusses the Adviser's past specific recommendations with respect to the securities in such client's account.
 - See Investment Counsel Ass'n of America, Inc. No Action Letter (March 1, 2004).

Most Frequent Advertising Rule Compliance Issues

- **Compliance Policies and Procedures.**
 - Advisers did not have, or did not implement, policies and procedures for reviewing advertisements, for both legal compliance and for accuracy.
- **Some Suggested Practices:**
 - Scheduling a regular time for the Compliance Officer to review the policies and procedures to ensure compliance;
 - Developing and implementing templates for use on a regular basis; and
 - Compliance review of each advertisement.

Examination Observations from Touting Initiative

- **Misleading Use of Third Party Rankings or Awards.**
 - Published advertisements containing references to awards or rankings from third parties that failed to disclose material facts about the awards or rankings.
 - Advertised accolades obtained by submitting potentially false or misleading information in the applications.
 - Published marketing materials that referenced stale ranking information, potentially misrepresenting the adviser's current status.
 - Published advertisements that did not disclose the relevant selection criteria or origin of the awards, or that the adviser paid a fee to be considered.

Examination Observations from Touting Initiative

- **Misleading Use of Professional Designations.**
 - Advisers' Form ADV Part 2B Brochure Supplements contained potentially false or misleading references to employee professional designations.
 - *Examples:* references to lapsed professional designations or failure to state qualifications required for the designation, such as CFA, CPA, CIC, ChFC, PFS, CFP.

Examination Observations from Touting Initiative

■ Testimonials.

- Compliance issues identified where advisers:
 - Published statements of clients attesting to or endorsing adviser services.
 - *Examples:* client endorsements published in firm websites, social media pages, reprints of third party articles, or pitch books.
 - Linked-In Guidance

Q/A and Conclusion



Michael K. Renentzky
Partner
Locke Lord LLP
Chicago
T: 312-443-1823
mrenetzky@lockelord.com



Tom Bohac
Associate
Locke Lord LLP
Chicago
T: 312-443-0337
tom.bohac@lockelord.com



Matthew J. Kutner
Associate
Morrison Foerster LLP
New York
T: 212-336-4061
mkutner@mofo.com

ATTORNEY ADVERTISING. Locke Lord LLP and Morrison & Foerster LLP disclaim all liability whatsoever in relation to any materials or information provided. This presentation is provided solely for educational and informational purposes. It is not intended to constitute legal advice or to create an attorney-client relationship. If you wish to secure legal advice specific to your enterprise and circumstances in connection with any of the topics addressed, we encourage you to engage counsel of your choice. © 2017 Locke Lord LLP and Morrison & Foerster LLP