

The logo for K&L GATES, featuring the text in white on an orange rectangular background.

K&L GATES

A blurred background image of a city skyline at night, with lights from buildings and streets creating a bokeh effect.

2016 INVESTMENT MANAGEMENT CONFERENCE

Advertising and Social Media for Mutual Funds

Aaron E. Ellias

David R. McCandless

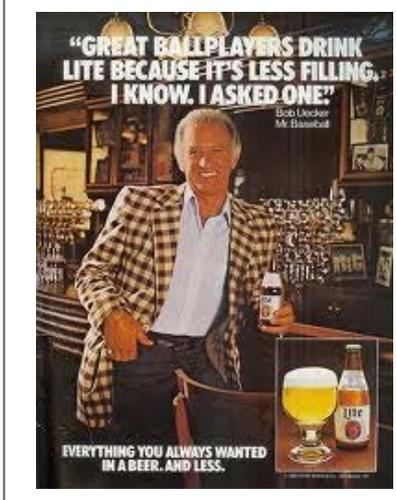
EXAMPLES OF “REAL” ADVERTISING



Demonstrating Product (Infomercials)



Building Image



Changing Perceptions



EXAMPLE OF A TYPICAL MUTUAL FUND ADVERTISEMENT

This ad is not an offer to sell nor solicitation of an offer to purchase.

The offer is only made by the prospectus.

ABC Fund

Copies of the prospectus may be obtained by calling 800-555-1212 or by going to abcfund.com

Past performance is not indicative of future results

Q: WHY IS MUTUAL FUND ADVERTISING SO DIFFERENT FROM REGULAR ADVERTISING?

A: Securities Regulation



SEC REGULATION

- Section 5 of 1933 Act: Limitations in Advertising
- Omitting Prospectus – Rule 482
 - Standardized Performance Disclosures
 - Money Market Fund Disclosures
 - Prominence and Disclaimer Requirements
- Supplemental Sales Materials – Rule 34b-1
- Generic Advertising – Rule 135a
- Advertising Standards – Rule 156
- Profile/Summary (Short form prospectus)

USE OF RELATED PERFORMANCE IN ADVERTISING

- SEC No-Action Letters and required conditions for use
- FINRA ban on use

FINRA REGULATION AND REVIEW

- NASD/FINRA Rules
- FINRA Advertising Review Rules
- General FINRA Standards – Rule 2210
 - Consolidation / Reorganization of rules about communication with the public

EXAMPLES OF NON-COMPLIANT ADVERTISEMENTS

The following slides include examples of advertisements that are non-compliant for the following reasons:

1. Includes Promissory Language
2. Includes Misleading Images
3. Inappropriate Presentation and Proximity of Performance Information
4. Problematic Graphics

Can you guess which number goes with which slide?

EXAMPLE A

ELLIAS SMALL CAP FUND

The Ellias Small Cap Fund seeks to achieve its investment objective by investing at least 80% of its net assets in the equity securities of smaller companies with market capitalizations at the time of investment between \$400 million and \$1.5 billion.



Past performance is not indicative of future results

EXAMPLE B



Are you ready to maximize your returns? Are you ready to invest with peace of mind? Then invest in the Ellias Extraordinary Returns Fund.

Ellias Extraordinary Returns Fund =
Guaranteed Returns.

EXAMPLE C

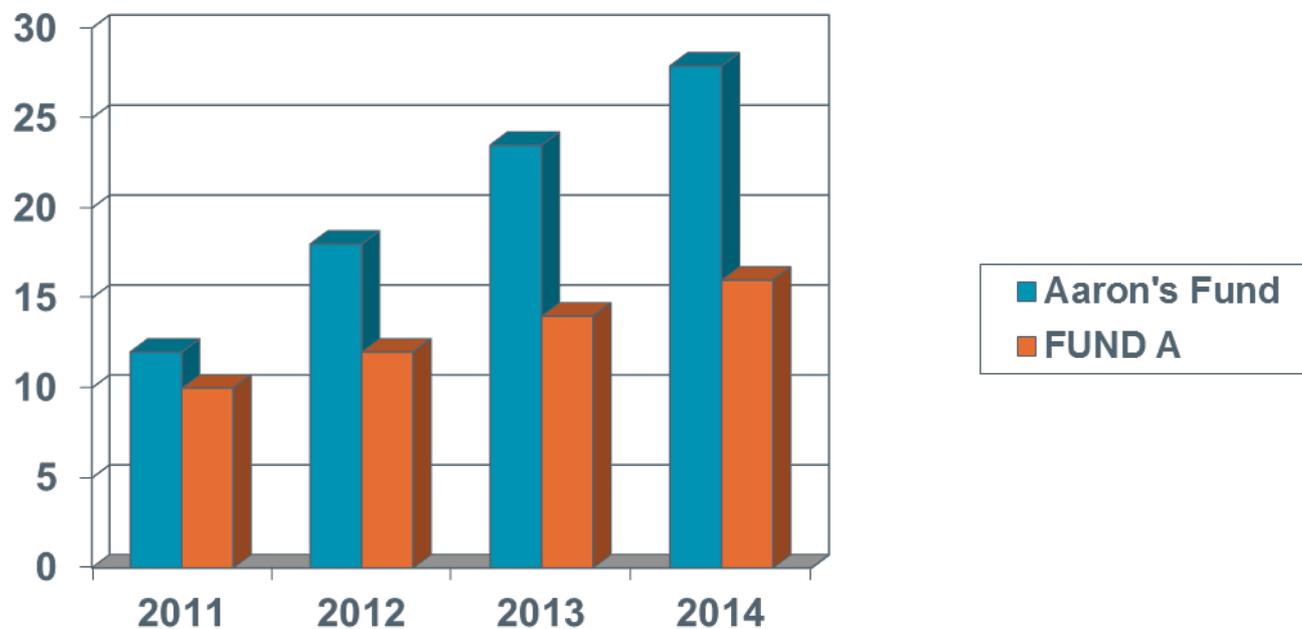
PERFORMANCE TABLE	
K&L Top Notch Fund -10.0%	Benchmark Index - 9.2%

The equity market performed well during the first half of this year and positive security selection in the Industrials and Financials sectors benefited the performance of the K&L Top Notch Fund as compared to its benchmark. Looking ahead, the Fund remains overweight in both of these sectors as they will certainly perform exceptionally.

The performance data quoted represents past performance of the Fund's primary class and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. To obtain the most recent performance data or the prospectus for the Fund, please call 1-800-555-5555.

EXAMPLE D

AARON'S LARGE CAP FUND (projected performance)



ELLIAS AWESOME COMMODITIES FUND

Goal: Guaranteed Returns.

PERFORMANCE TABLE

Ellias Awesome Commodities Aggressive Growth
Fund - 25.6%

MCSI China Index - 9.2%

The Ellias Awesome Commodities Aggressive Growth Fund always achieves its investment objective by investing in commodity-linked instruments and fixed income instruments or equity securities of smaller companies.

The team at Ellias Awesome Commodities Fund made me a ton of money last year!
- K.L. Gates, current investor

- Ideal investment to maximize returns with zero risk.
- Risk? What risk?
- We **will** generate at least 15% total return this year.
- Ranks first against comparable funds!



- The performance data quoted represents past performance of the Fund's primary class and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. To obtain the most recent performance data or the prospectus for the Fund, please call 1-800-555-5555.



Regulation of Social Media Use by Asset Managers



THE USE OF SOCIAL MEDIA BY ASSET MANAGERS

- I. What is Social Media and Why is it Important?
- II. Legal Framework and Regulatory Guidance
- III. Third-Party Posts and Content
- IV. Drafting Social Media Policies

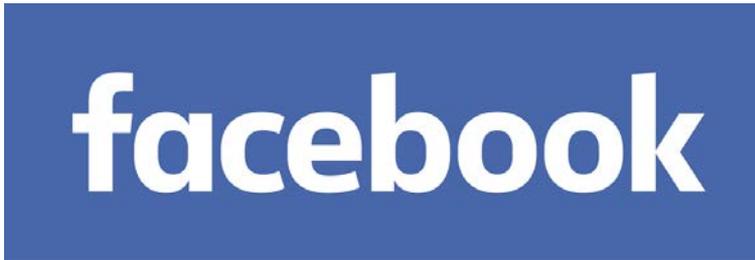
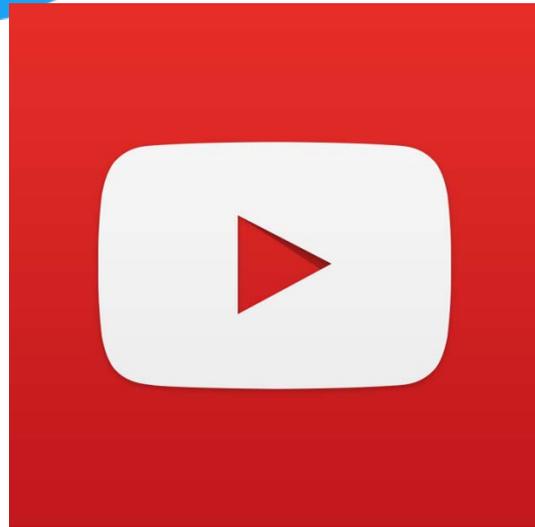


WHAT IS SOCIAL MEDIA? WHY IS IT IMPORTANT?

WHAT IS SOCIAL MEDIA?

“Social Media is an umbrella term that encompasses various activities that integrate technology, social interaction and content creation. Social media may use many technologies, including, but not limited to, blogs, microblogs, wikis, photos and video sharing, podcasts, social networking and virtual worlds.”

SEC National Exam Risk Alert (January 4, 2012)



COMMON USES OF SOCIAL MEDIA:

- Marketing
- Expanding brand awareness
- Promoting firm's website
- Building customer loyalty
- Connecting with clients and potential clients
- Educating clients/potential clients
- Servicing clients
- Customer/market research
- Identifying contacts within clients

Potomac Capital Management
@potomaccap

Potomac Capital Management is an investment management firm with an unyielding focus on helping investors achieve their long-term goals.

339 TWEETS
101 FOLLOWING
1,381,881 FOLLOWERS

Follow @potomaccap

Full name
Email
Password
Sign up

Tweets All / No replies

@potomaccap
Call us to learn more about our financial products!

@potomaccap
When it comes to investment advice, there's no substitute for our personal service.

@potomaccap
Thinking about a student loan? Go to our website for some helpful tips.

@potomaccap
At Potomac Capital Management, we strive to meet our clients' needs every day.

facebook



Grand Slam Investment Advisers LLP

128,877 likes · 1,507 talking about this

Bank/Financial Institution

A Prospectus is available at <http://gsia.pro.com/qwerty>.

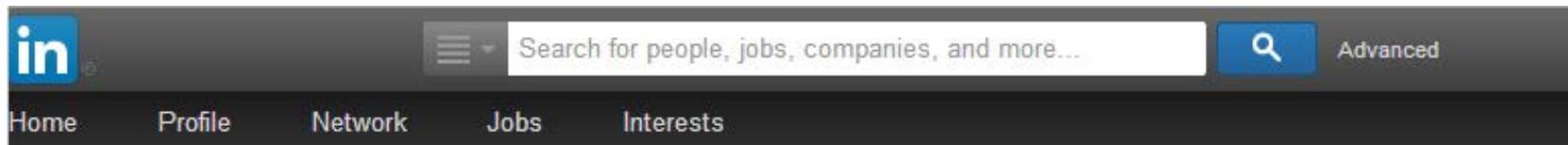
About – Suggest an Edit



Photos Likes

 **128k**





Ragnar Lodbrok

Portfolio Manager/Viking Aggressive Growth Fund

Kattegat

Current: Viking Ventures Capital Management LLC

Previous: Ragnorok Advisors LLC



LEGAL FRAMEWORK AND
REGULATORY GUIDANCE



CHANGING LANDSCAPES: APPLYING OLD STANDARDS TO NEW TECHNOLOGY

“Social Media is landscape-shifting. It converts the traditional two-party, adviser-to-client communication into an interactive, multi-party dialogue among advisers, clients, prospects, within an open architecture accessible to third-party observers. It also converts a static medium, such as a website, where viewers passively receive content, into a medium where users actively create content.”

REGULATORY FRAMEWORK FOR INVESTMENT ADVISERS, BROKER-DEALERS AND PRIVATE FUNDS

- Anti-Fraud Provisions:
 - Section 206 of the Investment Advisers Act (“Advisers Act”), Section 17(a) of the Securities Act of 1933 (“Securities Act”), Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934 (“Exchange Act”), Section 34(b) of the Investment Company Act (“1940 Act”), FINRA Rule 2210, CFTC Regulation 180.1, NFA Compliance Rules 2-29 and 2-36
- Advertising Rules:
 - **Advisers Act Rule 206(4)-1, FINRA Rule 2210**, Securities Act Rules 482 and 156, 1940 Act Rule 34b-1, CFTC Regulation 4.41, NFA Compliance Rules 2-29 and 2-36
- Compliance/Supervision Rules:
 - Advisers Act Rule 206(4)-7, 1940 Act Rule 38a-1, FINRA Rules 3110 and 3120, CFTC Regulation 23.602, NFA Compliance Rules 2-29 and 2-36
- Recordkeeping Rules:
 - **Advisers Act Rule 204-2**, Exchange Act Rules 17a-3 and 17a-4, FINRA Rules 2210 and 4511, Section 31 and 1940 Act Rule 31a-2, CFTC Regulations 1.31, 4.7(b), 4.12, 4.23 and 4.33, NFA Compliance Rules 2-29 and 2-36
- Suitability:
 - **FINRA Rules 2111 and 2114**

INVESTMENT ADVISER ADVERTISING REGULATIONS

- Advertising is any written communication addressed to more than one person or any notice or announcement in any publication or by radio or television which offers any analysis, report or publication regarding securities; any graph, chart, formula or other device for making securities decisions; or any other investment advisory services regarding securities
 - May include emails, websites or social media posts
- Investment advisers are prohibited from using advertisements that contain “untrue statements of material fact” or are “otherwise misleading”

Advisers Act Rule 206(4)-1

INVESTMENT ADVISER ADVERTISING REGULATIONS

- Investment advisers are generally prohibited from publishing, distributing or circulating advertisements with:
 - Testimonials
 - Past specific recommendations
 - Graphs, charts and formulas
 - Free reports and services
 - Untrue statements of material fact

Advisers Act Rule 206(4)-1

INVESTMENT ADVISER ADVERTISING REGULATIONS: SEC GUIDANCE FOR SOCIAL MEDIA

- Social media is subject to the advertising rules, including recordkeeping and production requirements
- Firms should identify risk exposure given their operations
- Firms should test if their compliance policies and procedures effectively address risks
- Firms may be responsible for third-party content

OCIE National Examination Risk Alert, *Investment Adviser Use of Social Media* (January 2012)

INVESTMENT ADVISER ADVERTISING REGULATIONS: SEC GUIDANCE FOR SOCIAL MEDIA

- Rule 204-2 and Recordkeeping:
 - Records relating to a firm’s “advisory business” must be kept
 - If records are kept in electronic format, must be arranged and indexed to promote easy access
 - Conduct employee training regarding required records and periodically test to make sure employees are not destroying required records
 - Consider use of third-party vendors to keep records

OCIE National Examination Risk Alert, *Investment Adviser Use of Social Media* (January 2012)

INVESTMENT ADVISER ADVERTISING REGULATIONS: SEC GUIDANCE FOR SOCIAL MEDIA

- Certain interactive content is not required to be filed under Section 24(b) of the 1940 Act or Rule 497 under the Securities Act
- Look at “content, context, and presentation of the particular communication or set of communications”
- Examine “the underlying substantive information transmitted”
- Is it a response to a request or inquiry from a social media user or is it forwarding previously-filed content?

IM Guidance Update, *Filing Requirements for Certain Electronic Communications*, March 2013

INVESTMENT ADVISER ADVERTISING REGULATIONS: FORM ADV SOCIAL MEDIA REPORTING

- Amendments to Form ADV now require an adviser to disclose social media platforms in addition to websites on Schedule D
- Disclosure is limited solely with respect to accounts on publicly available social media platforms where the adviser controls the content and the social media platform is used to promote the business of the SEC-registered adviser
- An account on a social media platform used solely to promote the business of a registered adviser's unregistered affiliate is not required to be disclosed
- “[O]ur staff may use this information to help prepare for examinations of investment advisers and compare information that advisers disseminate across different social media platforms”

FINRA GUIDANCE

- Targeted Examination Letter, June 2013 Re: Spot-Check of Social Media Communications
- FINRA Regulatory Notice 11-39 (Aug. 2011) – *Social Media Websites and the Use of Personal Devices for Business Communications*
- FINRA Regulatory Notice 10-06 (Jan. 2010) – *Guidance on Blogs and Social Networking Web Sites*
- FINRA Regulatory Notice 07-59 (Dec. 2007) – *Supervision of Electronic Communications*

FINRA GUIDANCE

Key Topics from FINRA Guidance

- Recordkeeping
- Suitability
- Prior approval vs. supervision
 - Static vs. interactive content
- Third-party posts

RECORDKEEPING

- Ensure first that you can retain records before allowing social media use.
- Content of the communication is determinative – must retain communications sent or received by firm or its associated persons that relate to broker-dealer’s “business as such.”
- Does not matter if employee sends a communication using a “personal” device – still subject to business as such standard.
- Includes third-party posts – rules require retention of records of communications received by firm or its associated persons relating to its business as such.

SUITABILITY (FINRA RULE 2111)

- Recommending a specific investment product or investment strategy in a social media post can trigger “suitability” requirements
- Broker must “have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer”
 - This belief must be based on “reasonable diligence of the member or associated person to ascertain the customer’s investment profile”
- Best practice to require pre-approval by a registered principal of any recommendations of a specific investment product or investment strategy
- Some firms prohibit references to specific investment products or strategies due to these issues

Prior Approval vs. Supervision (FINRA Rule 2210)

Static Communications

- Social Media Profiles
- Blogs
- Message Boards

- Retail communications require pre-approval by a registered principal

Interactive Communications

- Comments
- Status Updates

- Retail communications may not require pre-approval
- May become static communications if reposted, thus triggering the pre-approval requirement

*Recordkeeping requirements apply equally to both types of communications
(Retail communications are those made available to more than 25 people)*



THIRD-PARTY POSTS
AND CONTENT



TESTIMONIALS AND ENDORSEMENTS

- Includes an explicit or implicit statement of a client's experience with, or endorsement of, an investment adviser
- Testimonials are prohibited under Rule 206(4)-1 under the Advisers Act because they may suggest that all of the adviser's clients or investors have the same favorable experience as described in the testimonial
- SEC Risk Alert: Social "plug-ins," Facebook Likes and LinkedIn Recommendations could be testimonials depending on facts and circumstances

facebook



Grand Slam Investment Advisers LLP

128,877 likes · 1,507 talking about this

Bank/Financial Institution

A Prospectus is available at <http://gsia.pro.com/qwerty>.

About – Suggest an Edit



Photos

Likes **128k**

facebook

Our 128,877 “Likes” are a testament to the services we provide.



Grand Slam Investment Advisers LLP
128,877 likes · 1,507 talking about this

Bank/Financial Institution

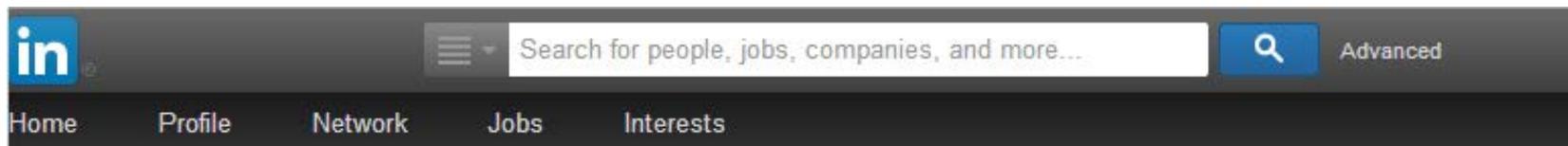
A Prospectus is available at <http://gsia.pro.com/qwerty>.

About – Suggest an Edit



Photos Likes

 **128k**



Ragnar Lodbrok

Portfolio Manager/Viking Aggressive Growth Fund

Kattegat

Current: Viking Ventures Capital Management LLC

Previous: Ragnorok Advisors LLC

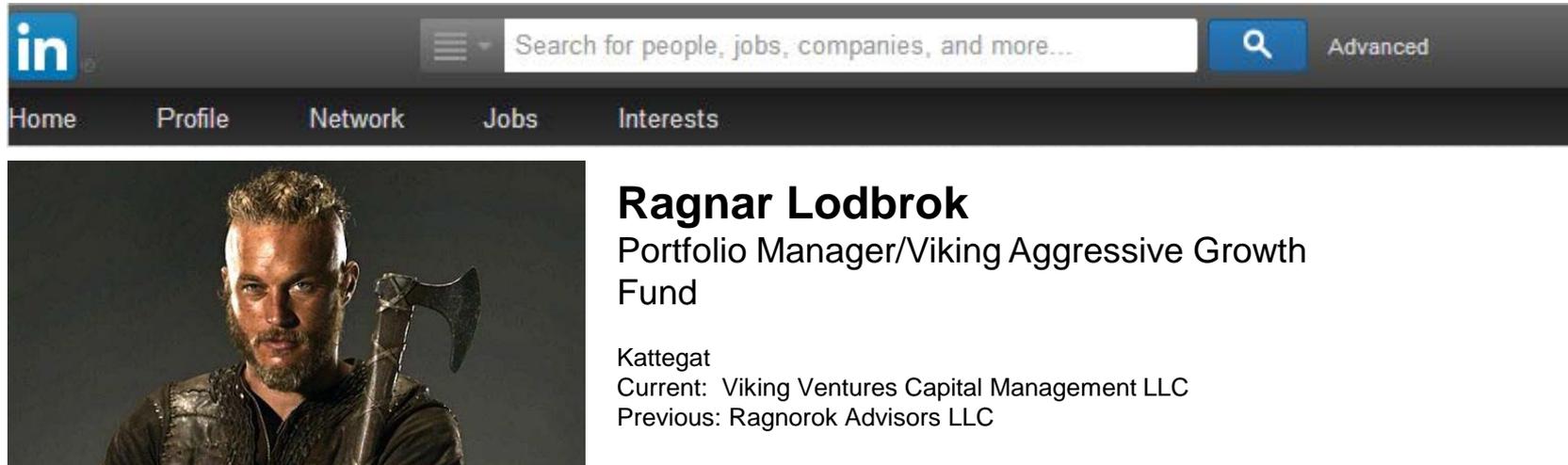
1 recommendation



Athelstan

Monk

My friend Ragnar is the best! He loves to travel to foreign countries and meet people. He is also a great sailor.



The image shows a screenshot of a LinkedIn profile for Ragnar Lodbrok. At the top, there is a search bar with the text "Search for people, jobs, companies, and more..." and a magnifying glass icon. Below the search bar are navigation tabs for "Home", "Profile", "Network", "Jobs", and "Interests". The profile picture shows a man with a beard and a Viking-style haircut, holding an axe. To the right of the profile picture, the name "Ragnar Lodbrok" is displayed in bold, followed by the title "Portfolio Manager/Viking Aggressive Growth Fund". Below the title, the text "Kattegat" is shown, followed by "Current: Viking Ventures Capital Management LLC" and "Previous: Ragnorok Advisors LLC".

▼ 1 recommendation



King Ecbert

Sovereign Wealth Investor

I have invested in the Viking Aggressive Growth Fund for over ten years and think that Ragnar is a great portfolio manager. The Fund's average annual returns are always above the total return of the S&P 500 index and the Fund frequently outperforms the other funds in its peer group.

ADOPTION AND ENTANGLEMENT THEORIES

- Advisers are responsible for the content that they or their representatives put on their webpage
- An adviser may also be responsible for content that it did not author if:
 - The adviser had some responsibility for its creation (**entanglement**)
 - The adviser has somehow endorsed it (**adoption**) after the content was created

ADOPTION AND ENTANGLEMENT THEORIES

Examples of Entanglement:

- A firm pays for an industry study
- Soliciting a recommendation on LinkedIn
- A firm employee posts a review of the firm

Examples of Adoption:

- Selectively removing content, such as unfavorable material
- “Retweeting” a post from a third party



Potomac Capital Management
@potomaccap

 **Follow**



Check out this article about how emerging markets funds are guaranteed to have the best returns this quarter:

www.badadvice.com

 Reply  Retweet  Favorite

47
RETWEETS

5
FAVORITES



LINKS TO THIRD-PARTY SITES:

- The SEC has employed adoption and entanglement theories in the context of a company's responsibility for third-party information that is hyperlinked to its Website
- Firm can't know or have reason to know that the site contains false or misleading information

SEC GUIDANCE ON THE TESTIMONIAL RULE AND SOCIAL MEDIA

- Genuine third-party social media commentary can be useful to investors
- Linking to commentary on third-party social media sites does not implicate the testimonial rule if three conditions are met:
 - The social media site provides independent content
 - There is no material connection to the independent site that could jeopardize its independence or the independence of the commentary posted on the site
 - All testimonial commentary from the site is included
- Entanglement and adoption may implicate the testimonial rule

SEC Division of Investment Management Guidance on the Testimonial Rule and Social Media (March 2014)

SEC GUIDANCE ON THE TESTIMONIAL RULE AND SOCIAL MEDIA

- Placing advertisements on the third party site does not jeopardize the site's independence
- List of contacts or “friends” on the social media website of an adviser or its personnel not an impermissible testimonial, even if the list is a partial client list May still be a misleading advertisement
- May provide links to third party sites – *See Us On*



COMMENTING GUIDELINES

- No personal information or information about your accounts
- No testimonials about how well you have done by investing with the firm
- No investment advice or recommendations about specific stocks or funds
- No attacks on the firm or fellow viewers
- No offensive or defamatory comments
- No illegal information, such as material, non-public information (insider trading)
- No customer-service related questions – contact us directly
- Read [third-party social media site's] terms of service and privacy policy, as they apply to communications through the page/account

DISCLAIMERS

- Firm is not affiliated with [third-party social media site] - use at your own risk
- Firm is not responsible for and does not endorse any content, advertising, advice, opinions, recommendations or other information from third parties, including [the social media site]
- Opinions, comments expressed by [friends or followers] are those of the persons submitting them and do not represent the views of the firm or its management
- Firm does not endorse or approve content submitted by third parties, or endorse individuals or organizations, by using any features on this site
- Firm reserves the right to block any third-party content deemed illegal, inappropriate or offensive
- Firm may block any posts that are testimonials, advice, recommendations, advertisements for specific products or services



DRAFTING SOCIAL MEDIA POLICIES

SOCIAL MEDIA USE BY INVESTMENT ADVISERS

- 90% of firms have adopted formal written policies and procedures to govern the use of social media by employees, up from 89% in 2015 and 83% in 2013
 - Additional 3.5% have informal policies
- 37% of firms prohibit use of personal social networking websites for business purposes, down from 47% in 2015, and 49% in 2013
 - 71% test compliance with the firm's social media policy, up from 70% in 2015, 63% in 2013)
 - 31.5% test annually

KEY TAKEAWAYS IN DRAFTING SOCIAL MEDIA POLICIES

- Identify business purposes for which firm wants to use social media, identify risks and draft procedures around purposes and risks
 - Perform cost-benefit analysis and identify resources available
 - Coordinate legal/compliance, IT, privacy departments on enterprise-wide basis to ensure policy addresses applicable laws
- Be specific about permitted or prohibited sites and permitted/prohibited features of those sites, and who can represent the firm

KEY TAKEAWAYS IN DRAFTING SOCIAL MEDIA POLICIES

- Specify account ownership, particularly for accounts used mostly for business purposes
- Monitor changes to features/settings on permitted sites and modify policy, as appropriate
- Incorporate regular training and education into the policy
- Organize and identify the process for pre-approving required content and monitoring interactive content/consider live monitoring

KEY TAKEAWAYS IN DRAFTING SOCIAL MEDIA POLICIES

- Make sure employees separate business and personal accounts
- Establish the extent to which personal use is permitted during business hours
- Identify inappropriate personal uses of social media (e.g., defamatory or illegal content, disparagement of competitors, use of company logo or other suggestions of endorsement, etc.)

KEY TAKEAWAYS IN DRAFTING SOCIAL MEDIA POLICIES

- Consider issues related to personal devices (e.g., monitoring, recordkeeping, unauthorized access, ability to separate business and personal communications)
- Monitor whether employee usage complies with policies and procedures and consider employee certifications
- If budget permits, use vendors for monitoring, site-blocking and recordkeeping

K&L GATES