

Morgan Lewis

webinar

Virtual Asset Management Roundtable Series:
Advertising and Social Media

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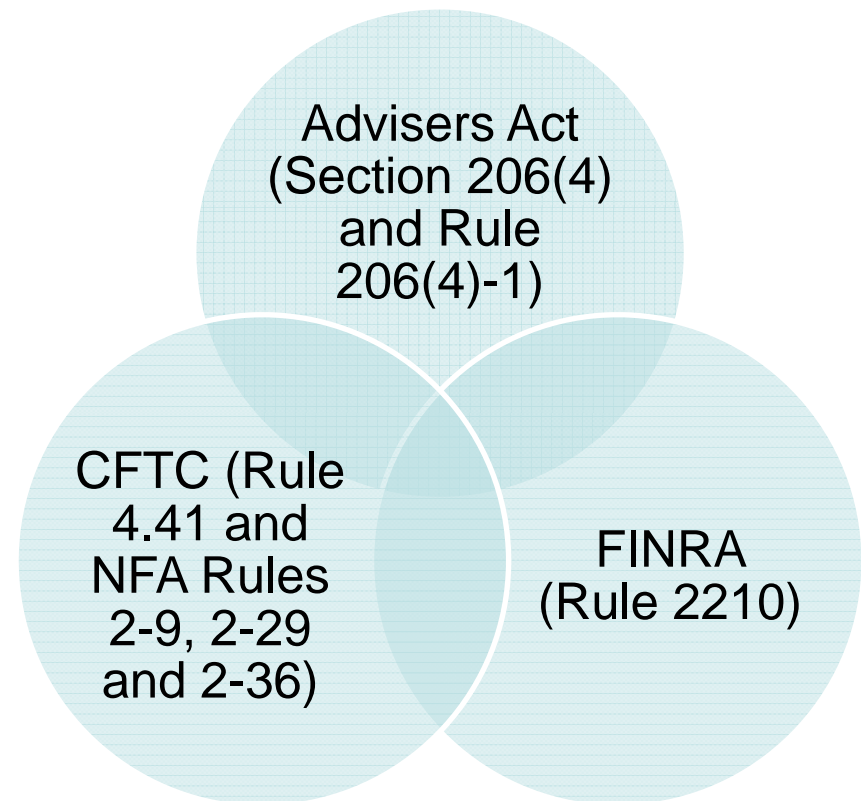
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Agenda

- Advertising
 - Backtested Performance
 - Past Specific Recommendations
 - SEC/CFTC Harmonization
- Social Media
 - Content Considerations
 - Supervision and Recordkeeping
 - Employment Law Considerations

Advertising and Social Media

- Increasing convergence of regulatory regimes for advertising, promotional materials and communications with the public
- Rapid adoption of social media by asset managers
- Rapidly evolving legal and regulatory landscape
- Increasing regulatory scrutiny



Advertising – Backtested Performance

- Advisers Act
 - Not per se fraudulent, but high burden to ensure that presentation is not misleading
 - Disclosure that describes limitations of backtested performance
 - Policed through SEC enforcement actions
 - GMB Capital Management LLC (Apr. 20, 2012)
 - Jason A. D’Amato (Aug. 31, 2012)

Advertising – Backtested Performance

- NFA Rules

- Only permitted if CTA or CPO does not have more than 3 months of actual performance for the trading system or program (or the CTA/CPO is exempt under Rule 4.7)
- Hypothetical results disclaimer is required
- Must include discussion of all assumptions underlying the compilation
- Must be clearly labeled as “Hypothetical Performance”

Advertising – Backtested Performance

- FINRA Rules

- Communications may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast (Rule 2210(d)(1)(F))
- Interpretive Letter to ALPS Distributors, Inc. (April 22, 2013) – permits the use of pre-inception index performance data in communications regarding certain exchange traded products distributed solely to institutional investors, subject to various conditions

Advertising – Past Specific Recommendations

- Advisers Act – Prohibits the use of advertisements that refer to past specific recommendations that were or would have been profitable unless the adviser complies with certain conditions
- NFA Rules - References to past results of specific trades are not advisable due to “cherry picking” concerns
- FINRA Rules – Prohibit references to past specific recommendations in retail communications or correspondence unless the broker complies with certain conditions

Advertising – Past Specific Recommendations

- Responses to unsolicited requests by clients, prospective clients or consultants relating to past specific recommendations are not advertisements
- Written communications sent to existing clients that discuss securities held by those clients are not advertisements, depending on context
- Policy concerns about cherry picking can be addressed by
 - Using objective, non-performance based criteria to select recommendations
 - Apply criteria consistently
 - Minimize or eliminate discussions of profitability
 - Maintain records

Advertising – SEC/CFTC Harmonization

- Some RIAs that manage registered investment companies are required to register as CPOs
- SEC and CFTC have separate, similar, but sometimes inconsistent requirements that are in the process of being harmonized through CFTC rulemaking process
 - Past Performance Disclosure – CFTC Rule 4.25(c) requires pools that have less than a 3 year operating history to disclose the performance of each other pool operated by the CPO
 - Break-Even Point and Fees and Expenses Disclosure – CFTC Rule 4.24
 - Updating Amendments – CFTC Rule 4.26

Social Media - General

- How is social media the same?
 - Same regulatory requirements that apply to traditional media apply to social media
 - Content of the communication is determinative
- How is social media different?
 - Multi-party dialogue
 - Interactive communication in real time
 - Recruiting brand advocates

Social Media - General

- Use by firm or its personnel of social media for business purposes (promotional content)
- Personal use of social media by firm employees
- Social media use in the hiring process

Social Media - Content

- Investment recommendations or recommendations of specific investment products
- Performance reporting
- “Cherry picking” past recommendations
- Third-party Content
 - Liability for Third-party Content
 - Testimonials

Social Media - Content

- Liability for Third-party Content
 - Entanglement – has the firm involved itself in the preparation of the content
 - Adoption - has the firm explicitly or implicitly endorsed or approved the content
 - Procedures for reviewing and deleting third-party posts
- Testimonials
 - A “testimonial” is any statement of a client’s experience or an endorsement by a client
 - Depending on the facts and circumstances, third-party use of the “like” button and other endorsement features on the adviser’s social media sites may be considered testimonials
 - Address through disclosure or by disabling or removing the plug-ins

Social Media – Supervision and Recordkeeping

- Policies and procedures for use of social media
- Usage criteria
 - Criteria for approving use of particular sites and features for firm communications
 - Ability of employees to post business-related information on personal sites
- Content restrictions
- Approval of content
 - Public appearance (unscripted participation in an interactive electronic forum) vs. advertisement (static posting)

Social Media – Supervision and Recordkeeping

- Manner and frequency of monitoring
 - Types of monitoring, including sampling, spot checking, lexicon or other search methodologies, and use of outside vendors
 - Requirement to delete inappropriate third-party content
- Training, education and certification, including about the differences business and non-business communications
- Information security
- Recordkeeping

Social Media – Employment Law

- Employee Rights Under NLRA Section 7
 - Section 7 of the National Labor Relations Act (NLRA) gives employees the right to discuss their pay and working conditions, and prohibits employers from disciplining or terminating employees for exercising such right.
 - This provision applies to **nonunionized** employees as well.

Social Media – Employment Law

- The NLRB treats “social media” complaints about employers no differently than more traditional complaints about employers.
- A policy may be challenged as unlawful under the NLRA even if it does not explicitly restrict Section 7 activity if:
 - Employees would reasonably construe the policy to prohibit Section 7 activity;
 - The policy was promulgated in response to Section 7 activity; or
 - The policy is applied in a manner that restricts Section 7 activity.

See Lutheran Heritage Village-Livonia, 343 NLRB 646, 647 (2004);
Sears Holdings Advice Memo, 18-CA-19081 (Dec. 4, 2009).

Social Media – Employment Law

- Problematic Policy Provisions
 - Restrictions on disparaging, confrontational, harsh, or even inappropriate communications regarding the company or its employees.
 - Restrictions on the distribution of “confidential” information.
 - Restrictions on employees presenting false, dishonest, or misleading information.
 - Restrictions on employee use of company logos and trademarks.
 - Requirement that employees obtain “approval” from the company before identifying or referencing their employment.
 - Inclusion of general disclaimer language in a policy to indicate that Section 7 rights are not infringed may not be enough

Social Media – Employment Law

- Social Media Use in the Hiring Process
 - Employer viewing applicant’s personal information on blog/social networking site may trigger protections of antidiscrimination laws.
 - Sites may contain information regarding age, race, national origin, disability, sexual orientation, and other protected categories.
 - Difficult for employer to prove it did not view and rely on the personal information if there is a later lawsuit in the absence of a policy prohibiting use of these sites for hiring.
 - Even if not unlawful, employer may be making employment decisions based on inaccurate information.
 - EEOC trial attorney Edward Loughlin cautioned that “**merely accessing**” the information could create “an issue for [a company] down the road when someone files a charge.”

Social Media – Employment Law

- Developing a corporate social media policy
 - Consider policy language found acceptable by NLRB
 - Define identified behaviors and activities
 - Give concrete examples
 - Harmonize social media with other policies
 - Use of disclaimers
 - Regularly review and refresh policies and rules
 - Training

Social Media – Employment Law

- *Walmart*, Case 11-CA-067171 – The Acting GC found that the social media policy was not ambiguous because it provided sufficient examples of prohibited conduct so that, in context, employees would not reasonably read the rules to prohibit Section 7 activity. For example, the social media rule:
 - Prohibited “inappropriate postings that may include discriminatory remarks, harassment and threats of violence or similar inappropriate or unlawful conduct.”
 - Counseled employees to avoid posts that “could be viewed as malicious, obscene, threatening or intimidating,” such as “offensive posts meant to intentionally harm someone’s reputation” or “posts that could contribute to a hostile work environment on the basis of race, sex, disability, religion or any other status protected by law or company policy.”

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