

INVESTMENT ADVISER AND MUTUAL FUND ADVERTISING

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How to Tell if a Communication is “Advertising”

A communication is advertising if it

- Is in writing, on tape or in a broadcast medium;
- Is addressed to more than one person; and
- Offers mutual fund shares or any securities–related investment advisory service

How to Tell if a Communication is “Advertising”

Rule of Thumb

- If the only rational purpose of material is marketing, it may be advertising
- When in doubt, treat a communication as advertising

Examples of Advertising

- Marketing brochures
- Paid advertising in periodicals and other publications
- Television, radio or other broadcast advertising
- Internet web sites

Examples of Advertising

- Form letters and mass mailings
- E-mail messages that are sent to multiple recipients
- Audio or video tapes of marketing presentations
- Slides used in marketing presentations

Examples of Advertising

- Press releases and some interviews
- Reprints of third party publications
- Questionnaires from independent rating services

Examples of Advertising

- Performance presentations used for more than one prospective client
- Telemarketing scripts
- Internal or dealer use only material that actually reaches clients or fund investors

Items that are NOT Advertising

- In person, telephone or other oral conversations
- Customized responses to advisory client questionnaires
- Responses to advisory client and fund investor requests for information

Even items that are not advertising are subject to SEC anti-fraud rules and enforcement action

Items that are NOT Advertising

- Regular account or fund shareholder statements and reports sent only to existing clients or shareholders
- But NOT not to solicit new business from or sell other funds to prospective or existing clients or shareholders

Items that are NOT Advertising

- Fund shareholder reports with performance information for only those periods covered by the financial statements
- Academic articles that discuss a portfolio management methodology, but do not offer advisory services or fund shares

SEC Restrictions on the Content of Adviser Advertising

Don't put the following in advertising

- Testimonials or offers to provide testimonials (*This can include photographs*)
- A selective list of fewer than all clients without disclosing the “as of” date, the basis for selection (*which can't be performance*) and that listing doesn't imply clients' recommendation of adviser

SEC Restrictions on the Content of Adviser Advertising

Don't put the following in advertising

- “Cherry picking:” performance data about selected past specific investment recommendations
- Any suggestion that a graph, chart, formula or other device for selecting securities may be relied on by investors, *unless* accompanied by a prominent warning about the limitations of using these devices

SEC Restrictions on the Content of Adviser Advertising

Don't put the following in advertising

- Any suggestion that a product or service is free, unless it is true and there are absolutely no strings attached
- Statements of fact or opinion which cannot be documented or proved (*even if you are sure they are true*)

SEC Restrictions on the Content of Adviser Advertising

Don't put the following in advertising

- Prohibited representations about compliance with AIMR standards
- Performance information that does not comply with SEC requirements

SEC Restrictions on the Content of Adviser Advertising

You may include in in advertising

- Accurate portfolio composition data such as industry, sector and country weights
- Accurate information about the adviser's personnel, history, business philosophy and portfolio management strategies and methodologies

SEC Restrictions on the Content of Adviser Advertising

You may include in in advertising

- Performance of indices or any other financial statistics (*other than actual or model account performance*) with disclosure of the “as of ” date and the source

SEC Restrictions on the Content of Adviser Advertising

You may include in advertising an entire list of recommendations for at least one year, accompanied by:

- Name of each security
- Date and whether recommendation was to buy, sell or hold
- The security's price on the recommendation date, the trade date and as of a recent date
- That future recommendations may not be profitable or perform as well as past recommendations

Fund Advertising: NASD Conduct Rule 2210 and SEC Rule 156

Don't include:

- Exaggerated, unwarranted or misleading statements or claims about
 - Management skill or techniques
 - Characteristics or the investment quality of the fund
 - Degree of risk involved
 - Effects of government supervision

Fund Advertising: NASD Conduct Rule 2210 and SEC Rule 156

Don't include:

- Any express or implied projection or promise of future performance
- Any statement of material fact that is untrue or otherwise misleading

Fund Advertising: NASD Conduct Rule 2210 and SEC Rule 156

You must include:

- Any statement needed to prevent information from being false or misleading
- The name of the NASD member who is the fund's distributor or selling dealer

Fund Advertising: NASD Conduct Rule 2210 and SEC Rule 156

You must include disclosure that:

- The net asset value and principal value of the fund's shares will fluctuate
- The fund's shares when redeemed may be worth more or less than their original cost

Fund Advertising: NASD Conduct Rule 2210 and SEC Rule 156

You may include:

- Performance data, if it is not misleading and is accompanied by a warning that it is based on historical results and may not indicate future results
- Performance rankings that comply with IM 2210-3 of NASD Regulation

Fund Advertising: NASD Conduct Rule 2210 and SEC Rule 156

You may include:

- Comparisons to other types of investments or indices, if accompanied by an explanation of
 - The purpose of the comparison
 - Any material differences between investing in fund shares and the compared investment

Fund Advertising: SEC Rule 134

Don't include:

- Any fund performance data
- Any information not expressly listed in Rule 134

Do include this legend:

For more complete information about the fund, including charges and expenses, please send for a prospectus from [name]. Read it carefully before you invest or send money.

Fund Advertising: SEC Rule 134

You may only include:

- A general description of the fund
- Investment objectives, investment policies and primary investments
- Whether the fund is diversified
- Fund's methods of operations

Fund Advertising: SEC Rule 134

You may only include:

- Services offered by the fund
- Names of the fund's adviser, distributor and principal officers
- How long the fund and/or adviser have existed
- Recent aggregate net asset value of the fund or all funds in the same group

Fund Advertising: SEC Rule 134

You may only include:

- Information about economic conditions, retirement plans or investor goals
- Any logo or graphic design
- Attention getting headlines

Fund Advertising: SEC Rule 482

Don't include:

- Any information that doesn't appear in the fund's prospectus or SAI
- Any non-conforming performance data, including non-standard yield or distribution rates
- Any application form to buy fund shares

Fund Advertising: SEC Rule 482

Do include this or a similar legend:

A prospectus containing more complete information may be obtained from [name]. An investor should read the prospectus carefully before investing.

Fund Advertising: SEC Rule 482

Do include, for money market funds, a prominent statement that:

- An investment in the fund is neither insured nor guaranteed by the U.S. government and
- There is no guarantee that the fund will be able to maintain a stable net asset value of \$1 per share

Fund Sales Literature: SEC Rule 34b-1

Don't include:

- Any information that is misleading or that contradicts the fund's prospectus or SAI
- Any non-conforming performance data, unless it is accompanied by the standard SEC total return and yield figures

DO say that the sales literature must be accompanied or preceded by the fund's prospectus

Fund Sales Literature: SEC Rule 34b-1

You may include:

- Any truthful information that is not misleading in the context of the sales literature
- Performance data that complies, or is accompanied by data that complies, with SEC standards, if accompanied by required legends and disclaimers

Using Performance Data in Adviser Advertising

Disclosure required in all performance
advertising

- The investment objectives and strategies of the accounts whose performance is shown
- The periods covered by the performance figures

Using Performance Data in Adviser Advertising

Disclosure required in all performance
advertising

- All relevant differences and similarities between the adviser's accounts and any index included for comparison purposes
- Whether performance data reflects the reinvestment of dividends and interest

Using Performance Data in Adviser Advertising

Disclosure required in all performance
advertising

- If the potential for profit is suggested, a warning concerning the possibility of loss
- Effect of material market or economic conditions on the performance shown
- That past performance is not an indication of future performance

Using Performance Data in Adviser Advertising

Deducting advisory fees and expenses from
performance figures:

SEC requirement: *Except in one-on-one presentations, performance figures must be presented net of the actual (or highest applicable) fees, expenses (other than custody fees) and brokerage commissions a client paid or would have paid*

Using Performance Data in Adviser Advertising

Deducting advisory fees and expenses from performance figures:

- The inclusion of gross performance with narrative disclaimers does *not* satisfy this requirement
- If the adviser does not charge a uniform rate to all clients, it may deduct from actual or model performance the highest applicable fee rate that could be imposed for that type of account

Using Performance Data in Adviser Advertising

Deducting advisory fees and expenses from performance figures:

- Gross performance data may accompany net performance data in advertising but no more prominently than net performance data covering the same periods

Using Actual Performance Data in Adviser Advertising

- Generally, performance data for a particular type of account should reflect the performance of all similarly managed client accounts
- Advisers may not “cherry pick” just the better performing accounts

Using Actual Performance Data in Adviser Advertising

It is okay to exclude accounts for the following reasons

- The excluded accounts are unrepresentative of typical client accounts
- The excluded accounts have dissimilar or atypical investment policies or sizes
- The excluded accounts have not been under the adviser's management for the period covered by the performance data

Additional Disclosure Required for Actual Performance Advertising

- That the performance results represent the performance of all or selected client accounts
- If the results represent the performance of fewer than all accounts, the basis for, and effect on performance of, selecting the accounts whose performance is shown

Additional Disclosure Needed for Model Performance Advertising

- The limitations inherent in model results, including that the results do not reflect actual trading or the impact of material economic and market factors on the adviser's decision-making process for actual client accounts

Additional Disclosure Needed for Model Performance Advertising

- Any material changes in the model or strategy during the performance period and the effect of these changes on the results shown
- *Do not use retroactive changes in the model to improve past performance results*

Additional Disclosure Needed for Model Performance Advertising

- Any material differences between the model and the current investment strategies actually being used or offered by the adviser
- Material differences in performance between the model and actual results achieved by the adviser's client accounts

Disclosure Required for “Backtested” Model Performance

- That the advertised results do not represent the results of actual client trading
- But were achieved through the retroactive application of a model constructed on the basis of historical data and designed with the benefit of hindsight

Disclosure Required for “Backtested” Model Performance

- That the model may not perform as well when applied prospectively
- *Note: Although not prohibited, backtested results are a frequent subject of enforcement proceedings and should therefore be either avoided or used with extreme caution*

One-on-One Presentations of Gross Performance Data

- You may present gross performance data in one-on-one presentations to clients who have the opportunity to ask questions and understand the significance of gross performance figures
- You may present gross performance data to consultants who agree to use it only in one-on-one presentations with their clients

One-on-One Presentations of Gross Performance Data

- Presentations are *not* one-on-one unless they are in person (*as opposed to the mailing of written materials*)
- Seminars and presentations to more than one prospective client at a time are *not* one-on-one presentations

Required Disclosure for One-on-One Presentations of Gross Performance Data

- That results do not include advisory fees
- That a client's return would be reduced by fees and other expenses
- That the adviser's fee schedule is described in Part II of the adviser's Form ADV (*even if actual fee rates are also included in the written materials*)

Required Disclosure for One-on-One Presentations of Gross Performance Data

- An example, in the form of a table, chart, graph or narrative, showing the compounding effect of the highest fee a client could be charged for that type of account

Fund Performance Advertising

- Complying with fund advertising rules leads to automatic compliance with most adviser performance advertising requirements
- All fund performance advertising should say that past performance is not an indication of future results

Money Market Fund Performance Advertising

Any quotation of yield should:

- Identify length of and last day in period
- Be computed in accordance with SEC formula and be either:
 - Current yield
 - Current plus effective yield for the same period and with equal prominence

Performance Advertising by Other Funds

- Only standard SEC yields and tax equivalent yields may be shown in stand-alone advertising--not distribution rates
- But, to assist with shareholder tax planning, a recorded telephone yield tape may disclose the scheduled date and dollar amount of expected dividends and distributions

Performance Advertising by Other Funds

- Standard SEC total return must be shown for 1, 5 and 10 year (or shorter life of fund) periods through the last calendar quarter
- The maximum applicable sales charge must be disclosed

Using Performance of Related Accounts in Fund Advertising

SEC no-action letters allow inclusion in fund advertising of performance for the following types of accounts:

- A portfolio that was rolled over into a registered fund and was not created as an incubator fund (allowed by NASD also)

Using Performance of Related Accounts in Fund Advertising

SEC no-action letters allow inclusion in fund advertising of performance for the following types of accounts:

- A substantially identical fund, non-fund account or group of accounts managed by the same adviser (would be allowed by a proposed NASD rule)

Common Adviser Advertising Violations in Recent Cases

- Overstatement of assets under management or years in business
- List of representative clients that includes only a particular type of client comprising only 10% of adviser's clients
- Testimonials from unnamed persons

Common Adviser Advertising Violations in Recent Cases

- Presenting composite performance that includes only the best performing accounts without disclosing this
- Failing to deduct fees from performance figures, failing to disclose that fees are not deducted or falsely stating that fees are deducted

Common Adviser Advertising Violations in Recent Cases

- Representing model or backtested performance as actual performance, not identifying limitations of model performance and showing model performance that is superior to actual performance without saying so
- Failing to disclose that performance reflects the reinvestment of dividends

Common Adviser Advertising Violations in Recent Cases

- Reporting fictitious performance results
- Falsely representing that performance figures are audited or AIMR compliant
- Making misleading comparisons with the performance of market indices
- Failing to keep supporting records

Top 10 Tips for Advertising Compliance Personnel

- Develop a comprehensive filing system for all marketing material. Know what marketing material your firm is circulating!
- Maintain backup records for all advertising material (i.e. numerical data for performance calculations)

Top 10 Tips for Advertising Compliance Personnel

- Check your web-site regularly and conduct your own periodic oversight of advertising and sales practices
- Provide training to your marketing staff on the current policies in effect. Establish compliance checklists and/or guidelines

Top 10 Tips for Advertising Compliance Personnel

- Supervise the process for distributing marketing materials
- Make sure that all material is current and that all 482 advertisements are consistent with the prospectus and SAI
- Establish a self-audit program for marketing

Top 10 Tips for Advertising Compliance Personnel

- Make sure that you are informed of any shareholder complaint that relates to advertising
- Establish written policies and procedures
- Review all questionnaires that are filled out