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THE USE OF SOCIAL MEDIA BY INVESTMENT COMPANIES, INVESTMENT ADVISERS, AND BROKER-DEALERS

With the rapid development of social media outlets on the Internet, the online presence of investment companies, investment advisers and broker-dealers has grown. While social media outlets expand the opportunities to communicate with current and potential clients, the use of these platforms gives rise to compliance-related issues—particularly regarding adherence to the rules that regulators promulgated, in certain cases, in a different technological time. As firms continue to expand their online presence and communicate with clients through social media platforms, investment companies, investment advisers and broker-dealers should be aware of the regulatory framework that governs the use of these outlets and review their compliance programs to ensure that they employ appropriate safeguards.

I. What is Social Media?

According to the SEC National Exam Risk Alert, " '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, photos and video sharing, podcasts, social networking and virtual worlds."

a. Common uses of social media:

i. Marketing

ii. Expanding brand awareness

iii. Building customer loyalty

iv. Connecting with clients and potential clients

v. Educating clients/potential clients

vi. Servicing clients

vii. Customer/market research

II. Legal Framework and Regulatory Guidance

a. Federal Securities Laws and SEC/FINRA Rules Applicable to Investment Companies, Investment Advisers, and Broker-Dealers

i. Anti-Fraud Provisions: Section 206 of the Investment Advisers Act ("IAA"), Section 17(a) of the Securities Act of 1933 ("Securities Act"),

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Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934 ("Exchange Act"), Section 34(b) of the Investment Company Act ("ICA"), FINRA Rule 2210, CFTC Regulation 180.1, and NFA Compliance Rules 2-29 and 2-36.

ii. Advertising Rules: Rule 206(4)-1 under the IAA, FINRA Rule 2210, Securities Act Rules 482 and 156, Rule 34b-1 under the ICA, CFTC Regulation 4.41, and NFA Compliance Rules 2-29 and 2-36.

iii. Compliance/Supervision Rules: Rule 206(4)-7 under the IAA and Rule 38a-1 under the ICA, FINRA Rules 3110 and 3120, CFTC Regulation 23.602, and NFA Compliance Rules 2-29 and 2-36.

iv. Recordkeeping Rules: Rule 204-2 under the IAA, Exchange Act Rules 17a-3 and 17a-4, FINRA Rules 2210 and 4511, Section 31 and Rule 31a-2 under the ICA, CFTC Regulations 1.31, 4.7(b), 4.12, 4.23, and 4.33, and NFA Compliance Rules 2-29 and 2-36.

v. Suitability: FINRA Rules 2111 and 2114.

vi. Private Offerings: Reg D – 502(c); 506(c) and interaction with CFTC Regulations 4.7(b) and 4.13(a)(3).

III. Determining Whether Communication on a Social Media Platform is an Advertisement

a. IAA Rule 206(4)-1

i. 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.

ii. Rule 206(4)-1 may include e-mails, websites or social media posts. If a communication on a social media platform is not an "advertisement" under IAA Rule 206(4)-1, investment advisers should still confirm that the communication complies with the general anti-fraud provisions under the IAA. If the communication on a social media platform is an "advertisement" under IAA Rule 206(4)-1, the prohibitions under the Rule must be considered as well:

1. Testimonials

2. Past specific recommendations

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3. Graphs, charts and formulas

4. Free reports and services

5. Untrue statements of material fact and material omissions

IV. Prior Approval vs. Supervision - FINRA Rule 2210

FINRA has made it clear that member firms must establish supervisory procedures for the use of social media for business purposes. Similarly, the SEC has recommended that firms consider whether pre-approval should be implemented, even where it is not required by law.

i. Static vs. Interactive Communications

1. "Static" content remains constant until changed by the author. Such content is considered to be an "advertisement" by FINRA and must be pre-approved by a registered principal. Examples of "static" content include Linkedin profiles of any website that does not provide for a visitor to leave any messages or commentary.

2. "Interactive" content is considered to be a "public appearance" and must be subject to reasonable post-use supervision, which may be risk-based. Examples of "interactive" content include interactive electronic forums or any portion of a social networking site that provides for interactive communications. Interactive content may become static if, for example, it is re-posted, which therefore may require approval.

3. Recordkeeping requirements are the same for static and interactive communications.

V. Recordkeeping Requirements for Social Media

a. IAA Rule 204-2 and Recordkeeping

Under Rule 204-2, investment advisers must maintain, among other things, communications about advice, orders, or funds, copies of publications and recommendations the adviser distributes to ten or more persons, and copies of performance advertisements and documents necessary to form the basis for such performance information. These recordkeeping obligations also apply to various media, including electronic communications, such as e-mails, instant messages and other Internet communications that relate to the advisers' recommendations or advice. Investment advisers should consider the following in addressing their

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recordkeeping obligations with respect to social media communications and postings:

i. How records will be stored. If records are kept in electronic format, they must be arranged and indexed to promote easy access.

ii. Training employees regarding required records and conducting periodic testing to make sure that employees are not deleting required records.

iii. Consider using third-party vendors to keep records.

b. FINRA Requirements

Pursuant to Exchange Act Rule 17a-4(b), a broker-dealer firm must preserve records of communications that relate to its business; this requirement encompasses electronic communications, whether they are firm-issued or made using a personal device.

i. *Autobiographical Information* - Depending on the context, posting autobiographical information such as job responsibilities or a list of products or services offered by the firm could be considered to be a business communication.

ii. *Communications Retention* - Firms and associated persons may not sponsor a social media outlet or use a communication device that includes technology which automatically erases the content of electronic communications.

iii. *Static versus Interactive Communications* - Recordkeeping requirements do not differ for static and interactive communications - they are governed by content.

c. Recordkeeping Takeaways Under Exchange Act and FINRA Rules

i. Ensure that you can retain records before allowing social media use.

ii. The content of the communication is determinative; firms must retain communications sent or received by the firm and its associated persons that related to the broker-dealer's "business as such."

iii. It does not matter if an employee sends a communication using a "personal" device; the communication is still subject to the "business as such" standard".

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iv. Recordkeeping requirements extend to third-party posts; therefore, communications received by a firm or its associated persons relating to its business as such must be retained.

VI. **Third Party Posts and Content**

Most social media websites not only allow but encourage visitors to the site to add their own remarks or commentary. When a social media site is used for business purposes, such third-party commentary raises a number of difficult compliance issues.

a. Testimionials and Endorsements

i. FTC Guidelines Concerning the Use of Endorsements and Testimonials in Advertisements

1. Endorsements must reflect "the honest opinions, findings, belief or experience of the endorser"

2. An individual or company making an endorsement or testimonial must disclose any material connection between the endorser and the company.

3. If a testimonial or endorsement does not contain specific substantiation of typical product results, the posting must clearly and conspicuously disclose the generally expected performance in the depicted circumstances.

ii. Is a third-party post a "testimonial" prohibited by IAA Rule 206(4)-1?

1. The SEC has said that social "plug-ins," Facebook "likes" and LinkedIn recommendations *could* be testimonials depending on the facts and circumstances.

2. Guidance from the Massachusetts Securities Division issued in January 2012 indicated that a client "liking" an adviser's webpage *could* be a testimonial. However, the Massachusetts Securities Division's position is that a client's "like" without more does not constitute a testimonial.

3. The Massachusetts Securities Division has also taken the position that a client recommendation posted on an adviser's LinkedIn page is prohibited testimonial.

b. FINRA Guidance on Third-Party Commentary - Adoption and Entanglement

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Attribution of third-party content is a key concern, because attribution may cause the content to become subject to a variety of requirements (licensing, disclosures and other content-based requirements, pre-approval or review, etc.)

i. As a general rule, third-party commentary on a social media website is not considered to be a communication with the public, unless the firm:

1. "adopts" it by explicitly or implicitly endorsing or approving the content or

2. is "entangled" with the content by involving itself in the preparation of the content (*e.g.*, paying for an industry study)

c. Links to Third-Party Sites - The SEC and FINRA have used the adoption and entanglement theories in the context of a firm's responsibility for third party information that is hyperlinked to its website. Firms cannot know or have the reason to know that the linked website contains false or misleading information.

i. In March 2014, the SEC issued guidance stating that linking to commentary posted on an independent social media site would not be deemed to be a prohibited testimonial if:

1. The independent social media site provides content that is independent of the investment adviser or its representatives;

2. There is no material connection between the independent social media site and the investment adviser or its representatives that would call into question the independence of the independent social media site or commentary; and

3. The investment adviser or its represntatives publish <u>all</u> of the unedited comments appearing on the independent social media site regarding the investment adviser or its representatives.

ii. If an investment adviser or its representatives draft or submit commentary that is included on the independent social media site (other than general advertisements placed on the site), the testimonial prohibition would be implicated.

d. Commenting Guidelines

i. No personal information or information about an individual's accounts

ii. No testimonials about how well an individual has done by investing with the firm

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iii. No investment advice or recommendations about specific stocks or funds

iv. No attacks on the firm or fellow viewers

v. No offensive or defamatory comments

vi. No illegal information, such as material, non-public information (insider trading)

vii. No customer service related questions - contact us directly

viii. Read the social media's website's terms of services and privacy policy, as they apply to communications through the page/account

e. Disclaimers

i. Firm is not affiliated with [insert name of third-party social media site] - Use at your own risk

ii. 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

iii. 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

iv. Firm does not endorse or approve content submitted by third parties, or endorse individuals or organizations, by using any features on this site

v. Firm reserves the right to block any third-party content deemed illegal, inappropriate or offensive

vi. Firm may block any posts that are testimonials, advice, recommendations, advertisements for specific products or services

VII. **Drafting Social Media Policies**

a. Key Takeaways in Drafting Social Media Policies

i. Identify business purposes for which firm wants to use social media, identify risks and draft procedures around purposes and risks

ii. Perform cost-benefit analysis and identify resources available

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iii. Coordinate legal/compliance, IT, privacy departments on enterprise-wide basis to ensure policy addresses applicable laws

iv. Be specific about permitted or prohibited sites and permitted/prohibited features of those sites, and who can represent the firm

v. Specify account ownership, particularly for accounts used mostly for business purposes

vi. Monitor changes to features/settings on permitted sites and modify policy, as appropriate

vii. Incorporate regular training and education into policy

viii. Organize and identify the process for pre-approving required content and monitoring interactive content/consider live monitoring

ix. Make sure employees separate business and personal accounts

x. Establish the extent to which personal use is permitted during business hours

xi. 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.)

xii. Consider issues related to personal devices (*e.g.*, monitoring, recordkeeping, unauthorized access, ability to separate business and personal communications)

xiii. Monitor whether employee usage complies with policies and procedures and consider employee certifications

xiv. If budget permits, use vendors for monitoring, site-blocking, and recordkeeping

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