February 8, 2012

Regulators Issue Guidance on Use of Social Media by Investment Advisers

SEC Reminds Investment Advisers of Social Media Risks; Charges an Investment Adviser for Abuse of LinkedIn

The SEC recently charged an Illinois-based investment adviser with offering to sell fictitious securities on LinkedIn. On the same day, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued its first Risk Alert regarding the use of social media by investment advisers (the "Alert").[1]1 Investment advisers who utilize social media to communicate with clients and potential clients or plan to do so need to be mindful of the applicable standards governing such communications. All investment advisers should expect in future regulatory exams that the SEC and state examiners will be inquiring about the firm's use of social media as well as related policies, procedures and supervisory practices. **SEC Enforcement Action** Pursuant to several federal securities laws, the SEC instituted administrative and cease-and-desist proceedings against Anthony Fields, a CPA, acting through a state-registered investment adviser and a purported broker-dealer. The order alleges that Fields used various social media sites, including LinkedIn, to offer to buy and sell more than $500 billion of fictitious bank guarantees and medium-term notes. The order also accuses Fields of: (1) failing to adopt or implement written policies and procedures, (2) filing a false ADV, (3) failing to have, maintain and enforce a written code of ethics and (4) publishing false and materially misleading information on various websites. Fields was also charged with acting as a broker without being registered. **SEC Risk Alert: *Investment Adviser Use of Social Media*** The SEC's Alert, titled *Investment Adviser Use of Social Media*, acknowledges the rapid expansion of the use of social media by the financial services industry and emphasizes that registered investment advisers and firms' use of social media "must comply with various provisions of the federal securities laws, including, but not limited to, the antifraud provisions, compliance provisions and recordkeeping provisions." The Alert consists of staff observations and is not intended to be a safe harbor or to provide an exhaustive list of all potential compliance matters. The Alert focuses on three main observations that advisers employing social media strategies should consider in connection with their obligations under federal securities laws: (1) the need for specificity in social media compliance programs, (2) the need to address what type of third-party postings are permissible to the extent they are permitted by the firm and (3) the need to retain records of social media communications in accordance with an investment adviser's record-keeping responsibilities.

Compliance Programs

First, the Alert notes that while advisers have general compliance programs that might apply to the use of social media, many firms have multiple overlapping procedures that apply to advertising, communications or electronic communications, which may or may not specifically address social media use. This lack of specificity in such policies and procedures may cause confusion as to what standards actually govern social media activity. The Alert therefore recommends that advisers adopt specific social media use compliance programs and includes a non-exhaustive list of factors for evaluating the effectiveness of such a program.

Some of the suggested factors to consider are as follows: (1) usage guidelines for investment advisory representatives ("IARs") and solicitors on appropriate and inappropriate use, (2) articulating clear content guidelines, (3) effective monitoring of the firm's site or third-party sites it might use, (4) consideration of pre-approval requirements for content, (5) training of

IARs on proper use, (6) requiring certification by IARs and solicitors of their awareness of such guidelines and (7) addressing whether to permit an IAR or solicitor to conduct firm business from a personal or third-party social media site.

Third-party Postings and the "Like" Feature

Second, the Alert recommends that advisers that allow third-party postings on social media sites have policies and procedures detailing what types of third-party postings are permissible, as well as reasonable safeguards in place to avoid securities laws violations. Notably, the Alert expresses the OCIE staff's view that, depending on the facts and circumstances relating to a third-party posting, the posting may constitute a testimonial of the type prohibited by the Investment Advisers Act of 1940, as amended (the "Advisers Act")[2]2. The Alert uses as an example, if the public is invited to "like" an IAR's biography on a social media site that election, in itself, could be viewed as a testimonial prohibited by the Advisers Act.

Record-keeping Provisions

Finally, the Alert notes that the Advisers Act's record-keeping obligations do not differentiate between the various types of media used to communicate with current and prospective clients.[3]3 The SEC staff's view is that the content of the communication is determinative of whether the communication comes within the adviser's record-keeping responsibilities. Accordingly, the Alert encourages advisers to review their document retention policies to ensure that any required records generated by social media communications are retained in compliance with the federal securities laws, including in a manner that is easily accessible for a period of not less than five years. The staff also reminds advisers to conduct employee training to educate advisory personnel about the adviser's recordkeeping provisions. **What Should an Investment Adviser Do Now** These recent developments emphasize the need for investment advisers whether state or federally registered who wish to use social media in their business to review their existing protocols and ensure that they adequately address the concerns raised by their regulators. This should include the following: ***Review of existing social media compliance program/setting parameters*.** Establish the parameters for use of social media by your firm. Although the SEC staff has suggested areas of concern and made certain recommendations, there is no one size-fits-all approach. To a large degree, the scope of your program will depend on the nature of your business, your business objectives and your available resources to monitor activity and comply with the requirements set forth in the guidance. Be realistic in your approach; there may be certain activity that you cannot satisfactorily monitor. For example, certain social media websites, such as Twitter, may be an inappropriate medium for discussion of performance advertising because of challenges to full and fair disclosure of all material information. Ensure the factors enumerated in the guidance are evaluated and addressed as needed. ***Written policies and procedures*.** Consider whether it is time to update internal policies and whether these policies properly take into account the potential uses of social media. The first step may be to understand the current use and what you anticipate in the future. Build in some flexibility to accommodate potential changes in how social media will be used. At its core, an effective policy should let all employees within the firm know what they need to know to communicate the firm's message effectively, and what they should and should not do. ***Training and certification*.** Once a new written social media policy is in place, employees should be retrained in accordance with the policy. It may be prudent to let your investors and clients know about the changes. Employees should also certify that they have read the policy and will abide by it. An e-mail or memo that includes a copy of the new policy or a link to where they can reference the policy should be sent to all employees and solicitors you may use. ***Continuous monitoring and compliance.*** Social media data is constantly changing. Third parties often have the ability to post and/or make comments. Therefore, effective compliance requires continuous monitoring to ensure that postings on the firm's site do not violate federal securities laws. This process should include retraining and monitoring what was put into place and a periodic evaluation on the effectiveness of the policies. ***Record-retention policies.*** Review and update record retention policies to ensure that any required records generated by social media communications are retained in compliance with the federal securities laws. Record-keeping related to social media may present one of the more difficult challenges for advisers. Do not be overinclusive, as certain social media interactions may not fall within the required record-keeping requirements. **Conclusion** While many advisers are eager to leverage the use of social media to market and communicate to existing clients and promote visibility, they need to be aware of the expectations of their regulators and the risks associated with using various forms of social media. Day Pitney attorneys are available to discuss these issues in further detail and assist you in preparing appropriate policies for dealing with these risks.

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[1] Coming just two weeks after the SEC's Alert, the Massachusetts Securities Division announced its guidelines for the use of social media for state advisers (the "Massachusetts Notice"), which is generally consistent but not necessarily duplicative of the SEC recommendations. For a detailed analysis of the Massachusetts's Notice, please see below article, "Massachusetts Securities Division Comments on Social Media Use by Investment Advisers."

[2] Rule 206(4)-1(a)(1) states that:

[i]t shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business... for any investment adviser registered or required to be registered under [the Advisers Act], directly or indirectly, to publish, circulate, or distribute any advertisement 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.

[3] Rule 204-2 requires investment advisers to make certain books and records relating to their advisory business ("required records") and to keep them for a specified period of time. In addition, the rule requires investment advisers that keep required records in an electronic format in a manner that allows the records to be arranged and indexed. *See* Section 204 of the Advisers Act and Rule 204-2 thereunder.

Massachusetts Securities Division Comments on Social Media Use by Investment Advisers

The Massachusetts Securities Division (the "Division") recently released an analysis of the findings of a survey sent to all 576 Massachusetts-registered investment advisers regarding their use of social media. The survey is similar to the recently released Securities and Exchange Commission Alert on this subject, *Investment Adviser Use of Social Media*.[1][4] The survey revealed Massachusetts investment advisers are increasingly utilizing social media as a way to connect with existing and prospective clients. Not surprisingly, such increased use is now bringing increased scrutiny. As the Division noted, "the potential harm from regulatory violations present on social media websites is magnified because of the potential for a much wider audience." Notably, the Division provided examples of instances in which an adviser may be responsible for information the adviser did not author, such as LinkedIn "recommendations," that may constitute a prohibited testimonial pursuant to Rule 206(4)-1 under the Investment Advisers Act of 1940, as amended (the "Advisers Act").

The survey indicated 44 percent of Massachusetts-registered investment advisers use at least one form of social media such as Facebook, LinkedIn or Twitter. Although the Division in its analysis noted that use of social media does not violate Massachusetts investment adviser rules or regulations per se, communications via social media pose new issues to consider from a regulatory and compliance perspective.

Record Keeping

Massachusetts-registered investment advisers should particularly note the Division's position that "as a general rule, web pages maintained by an adviser on a social media website like Facebook or LinkedIn will be considered advertising if the page is created or maintained in the name of the adviser or contains business-related content of the firm or solicitations for advisory services." Advisers Act Rule 204-2 requires investment advisers to retain advertising. Additionally, Massachusetts requires investment advisers to maintain a correspondence file or log with respect to advertising. Because social media websites are not static, the record-keeping requirements pose significant technological challenges for investment advisers.

Entanglement and Adoption

Complicating the compliance issues for Massachusetts investment advisers using social media is the fact that websites such as Facebook, LinkedIn and Twitter allow persons not associated with the investment adviser to post content on an adviser's social media Web page. The Division stated, "An adviser may also be responsible for the content it did not author if the adviser has some responsibility for its creation (entanglement) or has somehow endorsed it (adoption) after the content was created." "Entanglement" generally means the adviser has in some way been involved in the content's creation or preparation. For example, an adviser will likely be considered to be entangled with recommendations the adviser solicits and receives on LinkedIn. "Adoption" generally means the adviser has in some way explicitly or implicitly (through its actions)

approved or endorsed the content after it was created. An adviser that selectively deletes third-party material unfavorable to the adviser but continues to display favorable content may be deemed to have adopted the remaining content.

Advertising

Regulations adopted by the Division governing investment advisers require that, in addition to complying with Advisers Act Rule 206(4)-1 regarding advertising, advisers must ensure any advertising is true, does not misrepresent the qualifications of the employee or the nature of advisory services being offered, and is not misleading. Testimonials -- statements by clients or former clients that endorse the adviser or otherwise present a favorable experience of the adviser -- are a prohibited form of advertising. The use of social media presents a readily accessible medium through which clients and former clients may provide such statements regarding investment advisers. In particular, the Division examined whether the use of Facebook's "Like" button and LinkedIn's "recommendations" by clients and former clients constitute prohibited testimonials. The Division's position is that "a client's 'Like' of an adviser's Facebook page -- without more -- does not constitute a testimonial. In contrast ... there is a presumption that a client recommendation posted on an adviser's LinkedIn page is a prohibited testimonial." Other circumstances may change this analysis.

Compliance Enhancement Recommendations

The Division provided four recommendations to enhance investment advisers' compliance of their social media Web pages with respect to third-party content:

- Advisers should review their social media presence on a periodic basis and ensure any content that would be considered noncompliant is removed or hidden from view promptly. A review done daily would be considered reasonable supervision of an adviser's social media site.
- Advisers can avoid many of the potential "entanglement" and "adoption" issues by not soliciting third-party content on their websites or linking to third-party content they have not thoroughly reviewed.
- Advisers should consider incorporating disclosures on their social media Web pages. For example, on Facebook, an adviser could display the following: **"'Likes' should not be considered a positive reflection of the investment advisory services offered by [Investment Adviser]. Visitors to this page must avoid posting positive reviews of their experiences with the adviser or its services as such testimonials are prohibited under state and federal securities laws and may not reflect the experience of all clients of [Investment Adviser]."**
- In cases where an adviser can proactively block or disable content designed for a purpose at odds with the adviser's regulatory requirements, the adviser should consider proactively blocking the content.

Conclusion

The Division noted that while roughly half of all Massachusetts investment advisers use at least one form of social media, more advisers indicated they intend to use social media within the next year. Facebook, LinkedIn, Twitter and other social media websites quickly are becoming commonplace tools employed by investment advisers to connect with past, present and prospective clients. The release of the Division's analysis signals the heightened scrutiny regulators are applying to the use of social media. Massachusetts-registered investment advisers should re-evaluate their compliance practices in light of the Division's comments. Day Pitney attorneys are available to discuss these issues in further detail.

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[1] For a detailed analysis of the SEC's Alert, please see above article, "SEC Reminds Investment Advisers of Social Media Risks; Charges an Investment Adviser for Abuse of LinkedIn."