

SEC Publishes Risk Alert on Investment Adviser Use of Social Media

The SEC's Office of Compliance Inspections and Examinations ("OCIE") on January 4, 2012 released a National Examination Risk Alert ("Alert") concerning the use of social media by registered investment advisers.¹ The SEC also recently conducted a sweep in which OCIE staff sent a letter to numerous investment advisers requesting information as to the investment advisers' relevant policies and procedures concerning, and use of, social media (including, among others, Facebook, Twitter and blogs). Although SEC officials have publicly mentioned investment adviser use of social media as an area of potential concern and attention, the agency has not yet issued any formal guidance on the subject. While the Alert does not provide a safe harbor or other definitive guidance regarding the use of social media and compliance with federal securities laws, it does provide helpful observations based on the OCIE staff's recent review of investment adviser use of social media.

The Alert

In the Alert, the staff notes that the "use of social media by the financial services industry is rapidly accelerating" and encourages firms using social media to "adopt, and periodically review the effectiveness of, policies and procedures regarding social media in the face of rapidly changing technology." The staff goes on to make the following observations.

¹ Investment Adviser Use of Social Media, Office of Compliance Inspections and Examinations National Examination Risk Alert, Volume II, Issue 1 (Jan. 4, 2012).

General Observations

The staff notes that firms vary in their compliance program approaches to social media, and that many firms currently have multiple overlapping procedures that may generally apply to the use of social media, rather than a single, unified social media policy. The staff expressed concern that these overlapping procedures (covering, for example, advertisements, client communications or electronic communications) may create confusion regarding their application to the use of social media by investment advisory personnel and the types of social networking activity that are permitted or prohibited by an investment adviser.

Factors for Investment Advisers to Consider

The Alert sets forth a non-exhaustive list of factors that investment advisers are encouraged to consider when evaluating their compliance programs with respect to social media. This list includes:

Standards for Investment Adviser Representatives/Solicitors

- Usage guidelines on the appropriate and inappropriate use of social media for representatives and solicitors
- Standards for content created by the firm or its representatives or solicitors
- Policies and procedures to address representatives or solicitors who conduct firm business on personal or third-party social media websites

- Where the investment adviser is part of a larger corporate enterprise, it may wish to consider guidelines pertaining to enterprise-wide use of social media

Procedures for Monitoring Use of Social Media and Legal Compliance

- Frequency of monitoring of representative or solicitor activity
- Approval or pre-approval of posted content
- Sufficient dedication of compliance resources
- Criteria for approval of participation
- Training for representatives
- Certification by representatives and solicitors that they understand and are complying with firm policies and procedures
- Information security risks posed by representative access to social media websites

Third-Party Content and Testimonials

The Alert notes that while most firms allow third parties to post content to firm social media sites, the policies and procedures vary widely as to what types of postings are permitted. 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 Rule 206(4)-1 under the Investment Advisers Act of 1940 ("Advisers Act").² The staff asserts that functions such as the "like" button featured on sites such as Facebook "could be deemed to be a testimonial if it is an explicit or implicit statement of a client's or clients' experience with an investment adviser or representative." As an example of a potential testimonial, the staff states that if a third party "likes" a representative's biography posted on a social media site, that election could be viewed as a testimonial prohibited by Rule 206(4)-1.

² Rule 206(4)-1(a)(1) prohibits a registered investment adviser from publishing, circulating or distributing any advertisement which refers to any testimonial of any kind concerning the investment adviser or any services rendered by the investment adviser. This prohibition is intended to protect investors from reading a favorable testimonial and believing that all of the investment adviser's clients will experience the same results.

Recordkeeping Responsibilities

In the Alert, the staff also notes that the Advisers Act recordkeeping obligations set forth in Rule 204-2 do not differentiate between various types of media used to communicate with current or prospective clients. The staff's view is that the content of the communication determines whether the communication triggers recordkeeping responsibilities. The Alert suggests that investment advisers should consider reviewing their document retention policies to ensure that any records required by federal securities laws are retained and easily accessible for the requisite period.

Recent FINRA Regulatory Notices

In contrast to the general guidelines of the SEC staff's Alert, FINRA has released two regulatory notices that provide detailed, bright line answers to questions about member use of social media.³ The FINRA notices state that member firms are required to maintain communications related to the broker-dealer's business that are made through social media sites, and that such communications may trigger the suitability requirements of NASD Rule 2310.

Importantly, FINRA differentiates between static and interactive content, stating that static postings constitute "advertisements" under NASD Rule 2210. Static content generally is accessible to all visitors to a website and "remains posted until it is changed by the firm or individual" that posted the content. Currently, under FINRA regulations, interactive content is categorized as a "public appearance" for purposes of NASD Rule 2210.⁴ While public appearances, unlike advertisements, are not subject to prior FINRA approval,

³ See FINRA Regulatory Notice 11-39 (Aug. 2011) and FINRA Regulatory Notice 10-06 (Jan. 2010).

⁴ FINRA has proposed changes to Rule 2210, including the deletion of public appearance as a separate category of the term "communication." See Notice of Filing of SR-FINRA-2011-035, Rel. No. 34-64984 (July 28, 2011), 76 FR 46870 (Aug. 2, 2011). However, it appears that interactive social media content will be subject to the same supervisory requirements as "correspondence" under NASD Rule 3010(d). See Letter re: File No. SR-FINRA-2011-35 – Rebuttal from Joseph P. Savage, Vice President & Counsel, Investment Companies Regulation, FINRA, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Dec. 22, 2011) available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefiling/p125330.pdf>.

members are required to supervise communications made during such appearances in a matter reasonably designed to ensure that they do not violate the content requirements of FINRA's communications rules. The FINRA notices state that firms must still supervise interactive communications in accordance with NASD Rule 3010 and that interactive content can become static if it is copied or forwarded and posted in a static forum.

The regulatory notices also provide guidance related to third-party postings and content (e.g., when third-party posts may be attributed to a member firm).

Impact on Investment Advisers

Investment advisers may (depending on their operations) need to address the use of social media in the course of fulfilling their fiduciary, compliance and recordkeeping obligations. Given that the use of social media may not fit smoothly within existing federal securities laws and regulations relating to client disclosure/communication and advertising, it may present a challenging compliance matter for investment advisers.

Although the SEC staff and FINRA have suggested areas of concern and potentially relevant considerations to address, there is no one-size-fits-all set of policies and procedures appropriate for all usages of social media by investment advisers and their personnel. Therefore, an investment adviser that permits the use of social media should tailor its social media policies to suit its operations, taking into account the considerations suggested by the Alert and the FINRA notices.

The SEC is unlikely to issue more definitive guidance regarding the use of social media in the near term. Until more concrete guidance/market practice has emerged, firms may benefit from taking a conservative approach by limiting the use of social media and the ability of non-firm personnel to "like" or post content to the firm's social media website. Such an approach may be especially prudent if the OCIE staff takes a broad interpretation of the testimonial implications of the "like" function or other social media interactions. An expansive interpretation is, in our view, unwarranted, since "liking" an investment adviser's profile/Facebook presence does not necessarily testify to the user's experience with the investment adviser's services, and

social media users are unlikely to misinterpret a "like" as a testimonial.⁵

Monitoring and recordkeeping related to social media may also present challenges for investment advisers. Due to the difficulty of readily identifying which social media interactions may require records, some investment advisers may be tempted to capture all such interactions, notwithstanding that investment advisers, unlike FINRA member broker-dealers, are not required to retain all communications relating to their business "as such." Because the OCIE examination staff will likely request to review all communications retained by the investment adviser, regardless of whether those communications are required records, an investment adviser that retains records of all social media interactions may provide the examination staff with greater access to communications than is literally required under applicable recordkeeping obligations.



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⁵ The "like" function is most prominently used by Facebook. On this site, in order for a user to establish a relationship between the user's profile and a business's Facebook presence, the user must "like" the firm's profile. The "like" relationship allows the user to automatically receive updates, postings and other notices from the business as part of an ongoing, incoming stream of content from the totality of the user's Facebook friends and other "liked" businesses. Currently, there is no alternate way for users to establish Facebook connections with businesses outside of the "like" function.

Practice group contacts

For more information, please contact the authors, one of the attorneys listed or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/financial_services.

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