



Risk Management Update June 2010

ELECTRONIC COMMUNICATIONS AND SOCIAL MEDIA: FIRMS THAT TWEET, TWITTER AND FACEBOOK—PART I

Today's technologies are posing increased challenges to broker-dealers and investment advisers alike. Although FINRA has provided some guidance in its Notice to Members 10-06 on social media websites, the SEC has provided little direction on its expectation of their registrants. While the SEC, FINRA and other Self Regulatory Organizations (SROs) generally define recordkeeping requirements and internal control procedures for electronic communications, certain means of communications, such as text messaging and social media sites, (including Twitter, LinkedIn and Facebook) present unique supervisory and compliance challenges that firms now face. The use of such electronic communications has proved valuable to many firms utilizing the new technology for business growth. However, the challenge of monitoring such use and remaining compliant with applicable regulatory requirements could potentially outweigh that added value.

To permit or not to permit the use of these new technologies? That is the question.

In this month's RMU, we discuss some of the general principles recommended by FINRA for how firms may address these supervisory and compliance challenges. This includes addressing the following questions, among other things:

- What types of electronic communications require supervision?
- How to review and supervise communications?
- What types of written policies and procedures are needed?
- How frequently should review of electronic communications occur?

Importantly, as noted by FINRA, these areas do not comprise new regulatory requirements, but should be viewed as a guide to develop your compliance program in this particular area. Part I of our article will focus on what types of electronic communications require supervision and provide guidance on how firms may wish to review and supervise communications. Part II will address how to effectively develop written policies and procedures for electronic communications and social media sites and how to efficiently test and maintain such policies in the face of constantly evolving technology.

History of Regulation: Types of Electronic Communications that Require Supervision

Prior to 1998, SROs required firms to review and retain all communications of their registered representatives pertaining to solicitation or execution of any securities transactions.¹ This broad requirement was amended in recognition of the electronic tidal-

wave and rapidly growing use of electronic forms of communication, (“Ecoms”). For example, in 1998, the following Ecoms were identified as requiring recordkeeping and supervision:

1. E-mails sent to and from a firm;
2. Communications sent to and from personal email accounts and PDAs;
3. Blog and chat room entries by representatives;
4. Entries on personal websites controlled by representatives of a firm;
5. Podcasts prepared for customers;
6. Text messages sent from phone to phone; and
7. Webcasts.²

Typically, Ecoms are defined as any business communication that is sent or received, and can be preserved by electronic means.³ FINRA recognizes Ecoms may exist under several different categories, including correspondence, public appearances, advertisements, sales literature, reprints and institutional sales material.⁴ As these definitions encompass a vast amount of data, recent case law has outlined the following parameters:

- The determinative factor in deciding whether a communication must be retained is the content.⁵
- Internal communication related to the firm’s business must be preserved.
- Retention of all electronic communications may be the only way to truly retain all relevant communications, although firms are not required to keep non-business related communications.

Based on those guidelines, firms should assess the level of risk involved in each individual business and implement policies and procedures that mitigate those specific risks.

How to Review and Supervise Communications

Blocking Specific Sites

One way for firms to address supervisory concerns about Ecoms is to limit access to and/or prohibit certain types of communications, such as blogs or instant messaging. Other firms may put parameters around the use of social media sites (such as Facebook) and prohibit discussion about the company and limit to personal use. For those firms utilizing blocking functions, FINRA recommends periodic testing to ensure the programs are working as intended. In addition, firms that choose this course should have clear written policies and regarding these types of communications and provide training to new and existing employees on what is and is not prohibited.

Supervision of Communications

When implementing a supervisory system for review of electronic communications, most firms will engage a third party service provider to capture and survey electronic communications. In developing internal compliance controls firms should consider:

1. Utilization of a lexicon of words to identify “guarantees” and “promises” or other false and misleading terms;
2. Methods of “flagging” Ecoms that evidence customer complaints, problems or errors in client accounts;
3. Pinpoint areas that require supervisory review, (such as marketing reviews; checks to see whether the system is being circumvented); and
4. Educate employees on new firm policies and procedures regarding electronic communications⁶

Due to the volume of electronic communications received, many firms conduct random reviews of the Ecoms based on a certain percentage of communications generated. Others do “spot-checks” based on the firm’s business model and associated risks. Regardless of the method used, firms must conduct evaluations to identify issues and address any misrepresentations that may have been made inadvertently or otherwise.

Conclusion

In FINRA’s *Guide to the Internet for Registered Representatives*, it is noted that compliance responsibilities when communicating over the internet are the same as though communication was made face to face. As a good measure, it is important to remember that Ecoms which are made from firm electronic technologies and/or about the firm itself are subject to regulation and scrutiny. Therefore, always remember, if you would feel comfortable placing the communication on the front page of *The Wall Street Journal*, press the send button. Or, at the very least, remember that Compliance will be watching!

For more information, or to learn about how CCLS may be of assistance, please do not hesitate to contact us at (619) 278-0020.

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¹ *Supervision of Electronic Communications*, FINRA REGULATORY NOTICE 07-59, December 2007, at 5.

² Marcus R. Jones & Hugh M. Makens, *Traps in Electronic Communications*, 8 J. BUS. & SEC. L. 157, 160 (2007-2008).

³ *Id.* at 158-59.

⁴ FINRA, *Guide to the Internet for Registered Representatives*, available at <http://www.finra.org/Industry/Issues/Advertising/p006118> (last visited June 29, 2010).

⁵ For further guidance, please see the content standards found in NYSE Rule 472 and NASD Rule 2210.

⁶ See FINRA REGULATORY NOTICE 07-59, *supra* note 1, at 12.