



## Risk Management Update September 2011

### SOCIAL MEDIA – THE LATEST REGULATORY GUIDANCE FOR COMPLIANCE CONSIDERATIONS

The world is changing, and potentially the way we conduct business, because of social media. Former colleagues and old friends are able to reconnect easily through the help of Facebook, LinkedIn and Twitter. Now peers, professionals and potential clients are readily accessible because of social media. Instead of passing out fliers or networking at the country club, social media provides an effective, efficient means for financial institutions to expand its reach to new opportunities and connections.

There are, however, many regulatory compliance challenges to consider before using social media. FINRA has provided excellent guidance for broker-dealers and investment advisers to consider with its recent release of Regulatory Notice 11-39.<sup>1</sup> In our Risk Management Updates for [June](#) and [July](#) 2010, we discussed supervisory considerations, recordkeeping requirements and policy and procedure development surrounding the use of social media for business communications. In this month's Risk Management Update, we will highlight some of the key guidance provided under FINRA Regulatory Notice 11-39 ("RN 11-39"), including additional considerations for developing internal controls to mitigate potential risks surrounding a financial institution's use of social media.

#### Background

Before considering the regulatory considerations for social media, it is important to revisit the definition of what constitutes an advertisement. For investment advisers, an advertisement is broadly defined to include any written communication addressed to more than one person or any notice or other announcement in any publication or by radio or television that offers any investment advisory service.<sup>2</sup> For broker-dealers, an advertisement is defined as any material, other than an independently prepared reprint and institutional sales material, that is published, or used in any electronic or other public media, including any Web site, newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, or telephone directories (other than routine listings).<sup>3</sup>

In the context of social media, some content may be viewed as an advertisement, while others may be viewed as public appearances, or non-advertisements. For example, interactive posts, such as chatting, typically are analogous to a public appearance, which could have a differing supervisory structure compared to an advertisement. On the other hand, static content, such as

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<sup>1</sup> See FINRA Regulatory Notice 11-39, available at [www.finra.org/Industry/Regulation/Notices/2011/P124187](http://www.finra.org/Industry/Regulation/Notices/2011/P124187).

<sup>2</sup> Rule 206(4)-1 of the Investment Advisers Act of 1940, as amended, at <http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;rgn=div5;view=text;node=17%3A3.0.1.1.23;idno=17;cc=ecfr#17:3.0.1.1.23.0.159.33>.

<sup>3</sup> FINRA Rule 2210 at

[http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=10467&element\\_id=3617&highlight=2210#r10467](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=10467&element_id=3617&highlight=2210#r10467).

profile or wall information, typically remains unchanged and thus is analogous to an advertisement. It therefore is imperative for you to consider the different formats within social media when developing supervisory and recordkeeping controls and procedures.

### **Special Considerations for Data Feeds and Third-Party Sites**

A data feed is commonly used to upload information from the web, such as news, real-time stock quotes, investment information or blogs. Since data feeds are fed from third party sources, the investment firm carries the responsibility of having a reasonable belief that the information being continually provided is complete and accurate.

In RN 11-06, FINRA provides for various controls that financial institutions can implement for data feeds. First, firms should become familiar with the source vendor's proficiencies and abilities to provide accurate data at the time it is presented on the financial institution's website. To that end, firms should make due inquiry to understand the criteria used by vendors for gathering or calculating the types of data presented so that the financial institution can determine whether such criteria is "reasonable." Such reviews should be conducted on a periodic basis and if necessary, prompt action should be taken to correct any inaccuracies detected.

Additionally, investment advisers and broker-dealers alike should consider whether or not third-party links may subject them to "adoption" or entanglement" considerations, which generally carry more responsibility and potential liability for investment firms. "Adoption" typically occurs when a firm endorses a third-party's statements, which could include paying for the third-party link. "Entanglement" generally occurs when a firm participates in the development of the linked information.

Over the last few years, FINRA and the SEC have provided written guidance to investment firms by way of Notice to Members, Regulatory Notices<sup>4</sup> and Interpretive Releases regarding third-party links on investment firm internet sites. Consequently, investment firms should be aware that they could be held liable for the content of a third-party linked site if the firm knows or should have known that the linked information is false or misleading. Therefore, it is imperative for firms to take all reasonable steps to help ensure that any third-party site links are from reputable sources deemed to be reliable. Moreover, to avoid potential adoption and entanglement issues, consider adding disclosures, such as: "You are about to leave XYZ firm's website. We are not responsible for the content of this third-party site."

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<sup>4</sup> See generally "Ask the Analyst – Electronic Communications," NASD Regulation, Regulatory & Compliance Alert (Mar. 1999); FINRA: Guide to the Internet for Registered Representatives, *available at* [www.finra.org/Industry/Issues/Advertising/p006118](http://www.finra.org/Industry/Issues/Advertising/p006118); "Electronic Communications: Social Networking Web Sites" (Mar. 10, 2009) *available at* [www.finra.org/podcasts](http://www.finra.org/podcasts); SEC Guidance on the Use of Company Web Sites, SEC Rel. No. 34-58288 (Aug. 1, 2008); Use of Electronic Media, SEC Rel. No. 33-7856 (April 28, 2000); FINRA Notice to Members 05-48 (July 2005); FINRA Regulatory Notices 10-06 and 11-39 (August 2011).

## Conclusion

As the use of social media by investment firms continues to grow, so does regulatory scrutiny over financial firms' risk management controls. When developing your controls, consider the following risk management tips:

1. Define what content constitutes a "business communication" for purposes of social media and determine if your firm will permit the use of social media for such business communications. For example, many firms may permit employees to have a Linked-In page and list the financial institution's name, which would not necessarily be deemed a business communication, since such posting is similar to a resume, and would not be deemed an advertisement. Other firms have taken the position that if you list your job responsibilities or what services the financial institution provides, such communications could be deemed "business communications" and subject to either pre-approval by compliance or prohibition of posting, dependent upon whether the firm allows the use of social media for business communications.
2. Implement detailed written policies and procedures that outline the acceptable use of social media for business purposes, including what systems (*i.e.*, company issued versus personal electronic devices) are acceptable for use when posting and be sure to provide clear guidance on supervisory responsibilities.
3. Provide extensive training and education to employees on your firm's policies for using social media for business communications, including examples of what they can and cannot do.
4. Perform and document initial and periodic detailed due diligence on the third-party vendors who provide data feeds to the firm's social media sites.
5. Develop protocols to check that information posted to social media sites is correct, timely and accurate and consider adding disclosures when clicking on links to third-party sites.
6. Use technology solutions to capture all required books and records for social media sites.
7. Develop forensics for testing the effectiveness of your compliance controls for social media usage and refine as necessary.

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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