

Risk Management Update April 2014

SOCIAL MEDIA GUIDANCE FOR BROKER-DEALERS

The rules that broker-dealers must follow with regards to their use of social media differ from those affecting investment advisers ("IA"s). Of particular note are the different requirements covering "testimonials." Under Rule 206(4)-1(a)(1) of the Investment Advisers Act of 1940 ("testimonial rule"), IAs are generally prohibited from using or referring to testimonials in any advertisements and therefore must navigate this strict rule when posting information on their websites or in their use of social media.

Notably, in March 2014, the SEC's Division of Investment Management issued a Guidance Update regarding the application of the testimonial rule and social media,¹ which opened the door for IAs to publish, under limited circumstances, advertisements containing public commentary about the IA that appears on independent, third-party social media sites. For example, an IA can now link to or include the comments about the IA posted on the website "Yelp", so long as ALL (*i.e.*, both good and bad) of the unedited comments appear and the IA and its representatives are independent of Yelp.

Broker-dealers, on the other hand are allowed to post testimonials to their social media sites and to their firm's website, and use in advertisements, provided they adhere to the requirements under FINRA Rule 2210(d)(6).² Additionally and importantly, while testimonials may be allowed, broker-dealers are required under FINRA regulations to take a number of compliance steps and implement supervisory controls when using social media for business purposes. Below is a summary of the main requirements and considerations, along with some risk management tips to assist firms with remaining compliant.

Supervision – Use of social media sites like Facebook, LinkedIn and Twitter must be supervised and the firm is required to have policies and procedures in place to help ensure that the communications remain in compliance with applicable laws.

- Approve all social media sites that are to be used for business prior to use.
- Include in the firm's policies and procedures, which social media sites are permitted to be used for business purposes.
- Provide ongoing training to employees on the regulations surrounding advertising and the use of social media.
- Perform regular reviews of all social media sites used for business purposes by the firm and its employees (reviewing posts in interactive forums, conducting random "spot checks," etc.)
- Obtain annual certifications from employees that they understand and are adhering to all requirements and the firm's policies and procedures regarding advertising and social media use.

Recordkeeping – Broker-dealers are required by Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 to retain certain required books and records, which include business related electronic communications (*e.g.*, social media postings). Firms are required to maintain electronic

¹ <http://www.sec.gov/investment/im-guidance-2014-04.pdf>

² http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10648

communications records for a period of not less than three years, the first two in an easily accessible place. Any broker-dealer firm allowing the use of social media for business purposes must be able to retrieve and retain these records in accordance with the books and records rules.

- Ensure written supervisory procedures contain a detailed list of required books and records and outline the person(s) and/or departments responsible for maintenance.
- Consider using third party vendors (or other technology) for retention of electronic communications, including emails, texts, instant messages, and business social media site postings.
- Perform periodic reviews of the firm's books and records to confirm compliance.

Suitability – Broker-dealers must comply with FINRA's Rule 2111³ regarding suitability when dealing with customers. Rule 2111 provides that when a broker-dealer is offering a product or service to a customer, the broker-dealer must first determine, based on the information provided to them by the customer, that the product being offered is "suitable" for that particular customer.

- If allowing the use of interactive forums, have detailed procedures on what is and is not allowed to be discussed.
- Require pre-approval by Compliance or a registered principal of subject matter.
- Consider the use of pre-approved scripts and/or templates.

Communications Rule – FINRA updated its Communications Rule, known as Rule 2210 (*see* FINRA's Regulatory Notice 12-29⁴) to simplify the categories of communications. The new rules became effective in February 2013 and reduced the defined categories of communications to just three.

- **Institutional Communication** - is a written or electronic communication that is only made available to institutional investors but generally does not include the firm's internal communications.
- **Retail Communication** - is any written or electronic communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period. A "retail investor" is any person other than an institutional investor, even if the person does not have an account with the firm.
- **Correspondence** - includes any written or electronic communication that is distributed or made available to 25 or fewer retail investors within a 30 calendar-day period.

Since all three of the above categories include electronic communications, they must be applied to social media use to determine, among other things, when pre-approval is required by a firm's registered principal and whether filing with FINRA is necessary.

Additional guidance on social media use by broker-dealers was issued by FINRA in Regulatory Notice 10-06.⁵ which was issued in January 2010 and provides guidance on recordkeeping, suitability responsibilities, firm supervision of use of social media sites, third party posts, and types of electronic forums. FINRA uses a Q&A format to answer inquiries by broker-dealers and to further clarify

³ http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859

⁴ <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p127014.pdf>

⁵ <https://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120779.pdf>

questions in regards to the application of FINRA Rule 2210.⁶ For instance, the term "public appearance" is defined to include "unscripted participation in an interactive electronic forum such as a chat room or online seminar."

FINRA's Spot-Check of Social Media Communications

In June 2013, FINRA circulated a targeted examination letter regarding their review of broker-dealer firms' social media communications. Below is a summarized list of what FINRA requested:

- Explanation of how the firm uses social media;
- The URLs for sites the firm uses, when the firm began using each site and the names of all of the individuals using each site;
- Explanation of how the firm's employees use social media to conduct business;
- A copy of the firm's supervisory procedures concerning production, approval and distribution of social media communications;
- Explanation of the measures that the firm has adopted to monitor compliance with its social media policies; and
- A list of the firm's top 20 producing registered representatives who used social media for business purposes, including the rep's name, CRD number, and the dollar amount of sales made and commissions earned during the review period.

Conclusion

Use of social media and firm's compliance with FINRA's rules remains a hot topic with regulators. Firms that permit the use of social media for business purposes must make sure they have developed and maintain social media policies and procedures and have supervisory controls in place to ensure compliance with the recordkeeping, suitability, supervision, approval, filing, and content requirements.

Author: Brooke Freitas, Compliance Analyst, Core Compliance & Legal Services ("CCLS"). Editor: Tina Mitchell, Lead Sr. Compliance Consultant. CCLS works extensively with investment advisers, broker-dealers, investment companies, hedge funds, private equity firms and banks on regulatory compliance issues. For more information about this topic and other compliance consultation services, please contact us at (619) 278-0020, info@corecls.com or visit www.corecls.com.

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⁶ http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10648