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Social media compliance for investment advisers

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Social media pervades all aspects of society, from personal and social communications to entertainment, business and politics. Presidents and CEOs communicate through Twitter; political activists organize through Facebook; and businesses blur the distinction between content and advertisement through Instagram. It is no surprise then that government agencies and law enforcement now routinely look at social media activity, both in real time and after the fact, for evidence of illegal activity.

For its part, the Securities and Exchange Commission has shown an increasing focus on social media activity in its examinations and investigations, such as using LinkedIn profiles during enforcement investigation testimony to establish a witness's experience and citing public tweets as the basis for enforcement actions. One should assume that the SEC, whether in an examination or enforcement investigation, will review anything publicly available on the internet relevant to its investigation.

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The SEC has substantial surveillance tools in this regard. By way of example, in September 2018, the agency requested a quotation for, and ultimately awarded, a contract for a web-based subscription to a social media monitoring tool. The tool provides emailed alerts to SEC staff based on keyword searches for relevant topics.

It also provides the ability to monitor social media sites, including but not limited to Facebook, Twitter, Instagram, YouTube and LinkedIn. The tool also provides the ability to monitor public forums, message boards and public news sites.[1]

In the investment advisory space, the SEC has amended Form ADV to require disclosure of advisers' social media accounts; issued guidance and conducted a sweep examination related to advisers' use of social media (among other non-firm-email electronic communications); and brought enforcement actions against advisers and investment advisory representatives involving social media.

This spate of activity reflects the SEC's focus on social media as an area replete with risk for registered investment advisers and reinforces their obligations under the advertising, books and records, and compliance rules of the Investment Advisers Act of 1940.

Without careful attention to the changing communications landscape and regulatory requirements, advisers could inadvertently violate these rules. For example, an adviser inviting the public to "like" an investment adviser representative's biography that it posted on Facebook and then receiving "likes" could violate the Testimonial Rule.[2] And an adviser failing to maintain records of tweets that it issues to provide news about the firm or of private Facebook, WhatsApp or LinkedIn messages with clients about their investments could violate the Books and Records Rule.

TESTIMONIAL RULE

Section 206(4) of the Adviser's Act prohibits advisers from engaging in any act, practice or course of business that the SEC, by rule, defines as fraudulent, deceptive or manipulative. Rule 206(4)-1 governs advertisements made by advisers. Of particular relevance in the social media context is Rule 206(4)-1(a)(1), known as the Testimonial Rule.

Under this rule, an adviser may not publish or disseminate, directly or indirectly, "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."

In adopting the rule, the SEC expressed its view that testimonial advertisements are "misleading" because "by their very nature they emphasize the comments and activities favorable to the investment adviser and ignore those which are unfavorable."[3] Of course, advisers should keep in mind that an advertisement, even if not testimonial in nature, can violate Section 206(4) and other subsections of Rule 206(4)-1 if it is otherwise false or misleading.

Whether public commentary on social media is testimonial depends upon the facts and circumstances relating to the statement.[4] While the term "testimonial" is not defined in Rule 206(4)-1, SEC staff have consistently interpreted the term to include a "statement of

a client's experience with, or endorsement of, an investment adviser."[5]

Under this framework, commentaries posted directly on an adviser's website, blog or social media site that tout the adviser's services generally would be prohibited testimonials. As for third-party social sites, there are potential grey areas that prompted SEC staff to clarify some ways that social media commentary would not violate the Testimonial Rule.

For example, SEC guidance says an adviser or investment adviser representative may publish public commentary on its own website or social media site if:

- The commentary comes from an independent social media site (such as Yelp) with no material connection to the adviser or IAR that would call its independence into question;
- The adviser or IAR publishes all the unedited comments appearing on the independent site regarding the adviser; and
- The comments are organized in a content-neutral order, such as chronologically or alphabetically.

This guidance suggests that commentary on a social media site would not be sufficiently independent if, for example, the adviser or IAR does any of the following:

- Submits comments that are included on the site.
- Suppresses all or a portion of a commentary.
- Edits the commentary, or prioritizes the order of the commentary.
- Compensates the author, including with discounts or offers of free services.

BOOKS AND RECORDS RULE

Advisers Act Rule 204-2 requires advisers to make and keep certain books and records relating to their investment advisory business. The Books and Records Rule does not differentiate between various media. Rather, the application of the rule hinges on the contents of a communication. In practice, the main two parts of the rule applicable to social media are subsections (a)(7) and (a)(11).

Rule 204-2(a)(7) requires advisers to make and keep "[o]riginals of all written communications received and copies of all written communications sent by such investment adviser relating to (i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, (iii) the placing or execution of any order to purchase or sell any security, or (iv) the performance or rate of return of any or all managed accounts or securities recommendations," subject to certain limited exceptions.

Rule 204-2(a)(11) requires advisers to make and keep a copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more people.

COMPLIANCE RULE

Advisers Act Rule 206(4)-7, or the Compliance Rule, requires advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and rules thereunder, tailored to the risks of that adviser.

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According to the Compliance Rule's adopting release, an adviser's policies and procedures should address, to the extent relevant to the adviser, compliance with books and record requirements as well as advertising restrictions, among other things.

The Compliance Rule also requires an adviser to review, at least annually, the adequacy of the adviser's compliance policies and procedures and the effectiveness of their implementation.

GENERAL SOLICITATION AND REGULATION D

Moreover, an adviser that offers securities in a private offering in reliance on Regulation D under Section 4(a)(2) of the Securities Act of 1933 — a common vehicle for the issuance of private funds — will need to proceed with caution in disseminating any information on its offerings via the internet and social media.

To benefit from the exemption (or safe harbor) of Rule 506(b) of Regulation D, the issuer cannot use general solicitation or advertising efforts to market the securities. Information about the offering and/or performance underlying the security shared on the internet that is publicly available outside of the issuer's password-protected website, for example, could be deemed a general solicitation or advertisement to market the issuer's securities.

Advisers could instead rely on Rule 506(c) for its advised funds' offerings if they use social media extensively. Rule 506(c) permits general solicitation in sales to accredited investors but requires the collection of information that could be viewed as invasive and would require additional policies and procedures.

RECENT ENFORCEMENT ACTIONS

Putting its guidance into action, in July 2018 the SEC brought five separate settled proceedings against two advisers,

three IARs, and a marketing consultant who committed or caused violations of Section 206(4) and the Testimonial Rule via social media or other internet postings.[6] Notably, these proceedings all arose from examination referrals.

According to the SEC's orders, one adviser and its IAR, as well as two other independent IARs, violated the Testimonial Rule by using a marketing consultant to solicit client reviews on various social media websites including Yelp, Google and Facebook.

In addition, the SEC found that another adviser created and published two videos containing client testimonials on its public website and on YouTube. The reviews and videos included information on the advisers or representatives and the services provided to their clients.

Under the settlements, each adviser paid a $15,000 penalty, each IAR paid a $10,000 penalty, and the marketing consultant paid a $35,000 penalty.

In December 2018 the SEC settled enforcement actions involving social media activity of two robo-advisers that provide automated, software-based portfolio management services.[7] One of the SEC's settled orders found that the adviser improperly retweeted prohibited client testimonials and selected posts by other Twitter users without disclosing the economic interest of the adviser. It also paid bloggers for client referrals without the required disclosure and documentation, and it failed to maintain a compliance program reasonably designed to prevent violations of the securities laws.

The second SEC settled order found that one of the advisers failed to comply with, among other requirements, the Books and Records Rule. In this instance, the adviser posted comparisons of its clients' investment performance with those of two competitor advisers and failed to maintain sufficient documentation to substantiate certain posted data on its website and social media.

The SEC also found that the adviser's compliance program then in place was inadequate because it did not require the adviser's chief compliance officer to review and approve advertisements and promotional material posted on the adviser's website and social media. Instead, the program only required the chief operating officer's approval for written communications that would be sent to investors and prospective investors, which did not include communications simply posted online. The SEC found this program was too narrow, particularly because online marketing was the core of the adviser's business.

In addition, the SEC and other authorities, including the Commodity Futures Trading Commission, have continued to bring enforcement actions for garden-variety fraud by financial professionals on social media.

As a recent example, the CFTC filed a complaint in January against a trading adviser alleging that, among other misconduct, he defrauded more than 140 clients by making false representations about a purported forex investment opportunity, primarily on social media platforms including Instagram and WhatsApp.[8] On Jan. 29 the U.S. District Court for the Southern District of Texas entered a preliminary injunction prohibiting the trading adviser from engaging in further misconduct.[9]

CONCLUSION

In addition to advertising and recordkeeping requirements, advisers should keep in mind that social media usage could implicate other Advisers Act provisions and rules, including fiduciary and cybersecurity obligations.[10]

Given the evolving nature of social media and the SEC's increased interest in the space, advisers should stay up to date on the regulatory risks for the social media sites that they and their personnel use, as well as on further guidance from the agency.

NOTES

[1] Social Media Monitoring Subscription, Solicitation Number 50310218Q0111, https://bit.ly/2WbRD60.

[2] *Investment Adviser Use of Social Media*, National Examination Risk Alert, Office of Compliance Inspections and Examinations, SEC, Vol. 1, Issue 1 (Jan. 4, 2012).

[3] Investment Advisers Act Rel. No. 121 (Nov. 2, 1961) (adopting Rule 206(4)-1).

[4] Guidance on the Testimonial Rule and Social Media, Division of Investment Management, No. 2014-4 (March 2014); https://www.sec.gov/investment/im-guidance-2014-04.pdf.

[5] *Id.*

[6] SEC Charges Investment Advisers and Representatives for Violating the Testimonial Rule Using Social Media and the Internet, File Nos. 3-18586; 3-18587; 3-18588; 3-18589; 3-18590 (July 10, 2018).

[7] SEC Charges Two Robo-Advisers With False Disclosures, File Nos. 3-18949 and 3-18950 (Dec. 21, 2018).

[8] CFTC Charges Principal of a Purported Commodity Trading Firm with Social Media Based Fraudulent Scheme, Release No. 7871-19 (Feb. 14, 2019).

[9] *CFTC v. Ramirez*, No. 19-cv-140, Order (S.D. Tex. Jan. 29, 2019).

[10] For more information on best practices, we recommend reading OCIE Risk Alerts published in 2012 and 2018 on advisers' use of social media and electronic messaging, *Investment Adviser Use of Social Media*, OCIE, Volume II, Issue I (January 2012), https://bit.ly/1jffv4N, and *Observations from Investment Adviser Examinations Relating to Electronic Messaging*, OCIE (Dec. 14, 2018), https://bit.ly/2C6hUdC.

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