



Legal Risk Management Tip July 2013

RECENT SOCIAL MEDIA DEVELOPMENTS

Social media is a form of electronic communication (*e.g.*, websites for social networking and microblogging, such as LinkedIn, Facebook and Twitter) through which users create online communities that integrate technology, social interaction and content creation to share information, ideas, messages, and other content (such as videos).¹ The use of social media commenced in 2004, and is at an all-time high by businesses, including investment advisers and investment companies alike.

Social media allows advisers the ability to deepen their relationship with existing clients, acquire new clients and gain referrals. It allows a larger marketplace, and is becoming for the investor, a forum through which to vet potential managers.

As of December 2012, 67% of online adults use social networking sites.² Of these people, approximately 67% use Facebook, 16% use Twitter and 20% use LinkedIn as of August 2012.³ Looking at this further for the financial industry, 9 out of 10 financial advisers who use social media for business used LinkedIn, while less than 30 percent used Facebook, Twitter or Google+.⁴

Naturally, social media site usage by businesses as a method of communicating with customers is growing significantly. In 2012, 73% of Fortune 500 companies reported using a corporate Twitter account, while 66% have a corporate Facebook page.

This month's JLG legal tip focuses on the social media phenomenon and regulatory developments, recent enforcement cases, and practical tips for advisers to consider.

A. Rules Applicable to Investment Advisers

Shortly after FINRA's Regulatory Notices were released, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a National Examination Risk Alert in January 2012 (the "SEC Alert").⁵ Before this issuance, there was little guidance on compliance and recordkeeping requirements for investment advisers' use of social media, other than FINRA's Regulatory Notices, which do not apply to advisers, absent dual registration.

¹ Merriam-Webster Dictionary, available at <http://www.merriam-webster.com/dictionary/social%20media>.

² Pew Research Center's Internet & American Life Project Post-Election Survey (Nov. 14 – Dec. 9, 2012).

³ *Id.*

⁴ Reuters, Advisers Benefit from "Listening" on Social Media (Mar. 1, 2013) available at <http://www.reuters.com/article/2013/03/01/us-yourpractice-socialmedia-idUSBRE9200WL20130301>.

⁵ See "National Examination Risk Alert: Investment Adviser Use of Social Media" (Jan. 4, 2012) available at <http://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf>.

Generally speaking, social media activities by advisers are governed by the antifraud provisions found in the Investment Advisers Act of 1940, as amended (“Advisers Act”). Specifically, Rule 206 provides, “It shall be unlawful for any investment adviser...to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client.”⁶ In addition, advertising rules must be considered. Pursuant to Rule 206(4)-1 of the Advisers Act, investment advisers are prohibited from certain activities, which include using testimonials,⁷ providing past-specific recommendations,⁸ and making material misstatements or omissions.

The SEC Alert cautions advisers not only to the need to adopt and review the effectiveness of *specific* social media policies and procedures customized to the firm, but also to clarify which social networking activities are permitted or prohibited by the organization, including the use of social media by solicitors.⁹ The SEC suggested various factors that advisers should consider when developing and evaluating those internal controls surrounding social media use by the firm, its investment adviser representatives and solicitors, which include:

- Usage Guidelines
- Content Standards
- Monitoring and Frequency of Monitoring
- Approval of Content
- Firm Resources
- Criteria for Approving Participation
- Training
- Certification by Employees
- Functionality of Sites
- Personal/Professional Social Media Sites
- Enterprise-Wide Sites
- Information Security¹⁰

While the SEC Alert did not provide guidance on every feature on every new social-media channel, it did provide practical approaches, including a reminder to whenever possible, conform to those advertising and books and records rules that are already in place.

B. Guidance Applicable to Investment Companies - IM Guidance Update

In March 2013, the SEC’s Division of Investment Management issued IM Guidance Update No. 2013-01¹¹ to address the application of SEC filing requirements for certain fund-related interactive content as found in chat rooms and social media such as Facebook and Twitter, and

⁶ 15 U.S.C. §80b-6.

⁷ Exceptions exist for third party reports, partial client lists and ratings.

⁸ Past specific recommendations may be provided so long as the adviser complies with certain requirements found in SEC No-Action Letters, e.g., *see* Franklin Management, Inc., SEC No-Action Letter (Dec. 10, 1998) and The TCW Group, Inc., SEC No-Action Letter (Nov. 7, 2008).

⁹ *See* “National Examination Risk Alert: Investment Adviser Use of Social Media” (Jan. 4, 2012) at p. 2.

¹⁰ *Id.* at p. 3-5.

¹¹ IM Guidance Update, No. 2013-01 (Mar. 2013) *available at*

<http://www.sec.gov/divisions/investment/guidance/im-guidance-update-filing-requirements-for-certain-electronic-communications.pdf>.

set forth certain subjective criteria which can be used to determine whether communications need to be filed.

For example, there are several types of interactive communications that generally do not have to be filed. This includes *incidental* mention(s) of a specific fund not related to a discussion of the investment merits of the fund, such as “Fund X Family of Funds invites you to their annual benefit for XYZ Charity.”¹² It also includes incidental use of the word “performance;” hyperlinks to filed sales material; hyperlinks to broad investment concepts; and responses to an inquiry by a social media user that provides discrete factual information (such as refereeing the user to the fund’s prospectus or filed materials).¹³

On the other hand, other forms of interactive communications do need to be filed with the Commission¹⁴ under the filing requirements of Section 24(b) of the Investment Company Act of 1940 (“1940 Act”), or Rule 497 under the Securities Act of 1933 (“1933 Act”) subject to Rule 482. This includes interactive discussions of fund performance that either discusses or promotes all or some of the fund’s returns. For example, “Our quarter-end returns have exceeded our expectations” would trigger a filing requirement.¹⁵ Communications initiated by the fund that touts the benefits of investing in the fund also need to be filed with the Commission.

C. Use of Social Media by Public Companies

On April 2, 2013, the SEC issued a report of investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934 that clarified that public companies can rely on the application of Regulation Fair Disclosure (“Regulation FD”) to use social media to provide corporate disclosures and announcements, so long as investors are alerted ahead of time.¹⁶ The report confirmed that Regulation FD applies to social media, just as it does company websites, and therefore, can be used in a similar fashion to disseminate material information so long as investors know where to look for such information. On the other hand, the report of investigation also clarified that using the personal site of a corporate officer to disseminate such information without advance notice to investors would not likely be viewed as an acceptable method of disclosure under the securities laws.¹⁷ This guidance came in response to the SEC’s Division of Enforcement conducting an inquiry into Netflix CEO Reed Hastings, who posted on his personal Facebook page material information related to the company, and specifically, Netflix’s monthly online viewing had exceeded one billion hours for the first time. Notably, this information was not provided in any other form of a press release, nor on the company’s Form 9-K filing, and investors had no advance notice that such information could be provided on Mr. Hasting’s personal site.

¹² *Id.* at p. 1.

¹³ *Id.* at p. 1-2.

¹⁴ Investment company advertisements subject to Section 24(b) of the 1940 Act and Rule 482 of the 1933 Act are considered filed with the Commission if filed with FINRA.

¹⁵ IM Guidance Update, No. 2013-01 (Mar. 2013) at p 4.

¹⁶ Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Release No. 69279 (Apr. 2, 2013), available at <http://www.sec.gov/litigation/investreport/34-69279.pdf>.

¹⁷ SEC Press Release, “SEC Says Social Media OK for Company Announcements if Investors Are Alerted” (Apr. 2, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171513574>.

D. Recent Enforcement Cases

Over the past three and a half years, the SEC's Division of Enforcement has brought enforcement cases involving various uses of social media that resulted in violation of securities laws, rules and regulations. Below are some of the most notable cases.

In the Matter of Jenny Quyen Ta, Respondent; FINRA Letter of Acceptance, Waiver and Consent, No. 2010021538701 (Nov. 23, 2010) – Ms. Ta was the former founder of Titan Securities. When she sold her interests in the company in 2006, she continued to serve as a registered principal. In 2009, while at Titan, Ms. Ta maintained a Twitter account with over 1,400 followers, and posts of 372 tweets. 32 of these tweets referenced Advanced Micro Devices (NYSE: AMD), which she was extremely optimistic and positive about, predicting an imminent price rise. For example, one tweet stated:

“Its going 2 b a good Xmas & 2010! Ck out AMD! Like I have said, it should b @ least a \$10B co. which should b @ \$ 15/shs. HappyTrading!”

Tweets throughout Ms. Ta's account contained projections about future share price increases. Not only did Ms. Ta fail to inform the Titan principal about her Twitter account, but moreover, Ms. Ta failed to disclose that she and her family held over 100,000 shares of AMD. FINRA found the AMD tweets to be unbalanced, lacking adequate disclosure about conflicts of interest and the “substantial positions” held by Ms. Ta and her family. For this, Ms. Ta was fined \$10,000 and received a one-year suspension.

In the Matter of Anthony Fields, CPA d/b/a ANTHONY FIELDS & ASSOCIATES and d/b/a PLATINUM SECURITIES, Rel. No. IA-3348 (Jan. 4, 2012) – Mr. Field was the sole owner of Anthony Fields & Associates, an SEC registered investment adviser, and owner of Platinum Securities Broker, a firm that had applied for membership to FINRA, but withdrew its application in September 2010. Through LinkedIn and other social media, Mr. Fields advertised the availability of several types of prime bank schemes which turned out to be fraudulent. Specifically, he offered to buy and sell fraudulent bank guarantees and medium term notes, which promised significant returns, in exchange for transaction-based compensation. For this, the SEC administrative law judge found that Mr. Fields committed fraud as a result of his LinkedIn posting, barred him from the securities industry, revoked his registration and fined him \$150,000.

SEC Report of Investigation of Netflix, Inc. (Apr. 2013) – Last summer, Netflix CEO Reed Hastings posted information on his personal Facebook, posting that “Netflix monthly viewing exceeded 1 billion hours for the first time ever in June [2012].”¹⁸ Within 24 hours of the post, Netflix stock price shot up \$11.27 a share, prompting an SEC investigation. Mr. Hastings, who has social media accounts such as Twitter and LinkedIn,¹⁹ argued that “posting to over 200,000

¹⁸ Eric Savitz, Netflix Tops 1B Streaming Hours In June; Citi Stays Bullish, Forbes, July 3, 2012, *available at* <http://www.forbes.com/sites/eric savitz/2012/07/03/netflix-tops-1b-streaming-hours-in-june-citi-stays-bullish/>; *see also* <http://www.facebook.com/reed1960>.

¹⁹ <https://twitter.com/reedhastings>; <http://www.linkedin.com/in/reedhastings>.

people is very public” and “the fact of 1 billion hours of viewing in June was not ‘material’ to investors.”²⁰

The SEC did not take action against either Hastings or Netflix, and instead, clarified Regulation FD, which was much needed in the industry.

Conclusion

In June 2013, FINRA issued a sweep letter²¹ spot-checking social media communications and requesting the following information:

- Explanation of how the firm uses social media and blogs at the corporate level;
- Firm WSPs regarding the production, approval, and distribution of social media;
- Explanation of the measures adopted to monitor compliance with the firm’s social media policies (such as through trainings, certifications and technology);
- List of the top 20 producing RRs who used social media to interact with retail investors, including type of platform;
- URL for all sites used by the firm, date began using each site, and identity of all individuals who post/update the content; and
- Explanation of how the firm’s associated persons use social media, including dates of first use of each platform.

From the subject matters identified in the sweep letter, firms should pragmatically assess these areas. Perform a gap analysis to identify potential areas of weakness. Train supervisors to ensure competency and consider new technology applications, such as the endorsement feature on LinkedIn, to ensure that policies are developed to address these advances. Review applicable regulatory guidance updates and consider recent enforcement cases when structuring internal controls so that you can continue tweeting, posting and linking. Don’t be afraid of social media – it is here to stay. Just take the time to develop practical safeguards to protect the firm so that marketing efforts can excel.

For more information on these and other considerations, please contact us at info@jackolg.com, or (619) 298-2880. Also, please visit our website at www.jackolg.com.

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²⁰ See SEC Release No. 69279 (Apr. 2, 2013) available at <http://www.sec.gov/litigation/investreport/34-69279.pdf>.

²¹ See FINRA Targeted Examination: Social Media (Jun. 2003) available at <http://www.finra.org/Industry/Regulation/Guidance/TargetedExaminationLetters/P282569>.