

Regulation and Compliance—New Guidance on RIA’s Use of Social Media

It is probably no coincidence that on the same day the SEC charged an Advisor with offering to sell more than \$500 billion of fake securities on LinkedIn and other social networking sites, it also issued two alerts related to the use of social media by Advisors. One alert is aimed at investors while the other targets RIAs.



As the SEC points out, the latter alert is directed specifically at RIAs; however broker-dealers are subject to guidance on this topic issued in January 2010 and August 2011. Dual registrants, firms providing both brokerage and investment advisory services, must “adhere to both the federal securities laws and FINRA applicable rules.”

Investor Alert

The investor alert is straightforward. Basically, the alert reiterates many of the usual tips for avoiding investment scams, but also includes specific examples of fraud in the context of social media. The examples provided include:

“Pump-and-Dumps” and Market Manipulations—These schemes involve touting a company’s stock (typically small, so-called “microcap” companies) through false and misleading statements, often made on social media such as Facebook and Twitter, as well as on bulletin boards and chat rooms. According to the SEC, promoters often claim to have “inside” information about an impending development or to use an “infallible” combination of economic and stock market data to pick stocks. In reality, the promoters stand to gain by selling their shares after the stock price is “pumped” up by the buying frenzy they themselves create. Once the fraudsters “dump” their shares and stop hyping the stock, the price typically falls, and investors lose their money.

Fraud Using “Research Opinions,” Online Investment Newsletters, and Spam Blasts—

While recognizing that legitimate online newsletters may contain useful information about investing, the SEC warns that “others are merely tools for fraud.” According to the SEC, some newsletters recommend stocks without properly disclosing that they were paid to do so (in cash or stock) by the very companies whose stocks are being promoted.

High Yield Investment Programs—The hallmark of “high-yield investments” or “HYIPs” is the promise of incredible returns at little or no risk to the investor. A HYIP website might promise annual (or even monthly, weekly, or daily) returns of 30 or 40 percent – or more.

Investors are warned that if they are approached online to invest in one of these, they “should exercise extreme caution.”

Internet-Based Offerings—Offering fraud involves “material misrepresentations” in connection with the offering of a security. For example, the SEC cites a recent case in which fraudsters allegedly used a website to offer investors a “guaranteed return” of 1.2 percent per day. Other online offerings may not be fraudulent *per se*, but may nonetheless fail to comply with the applicable registration provisions of the federal securities laws.

Advisor Alert

Neither SEC nor the FINRA prohibits Advisors from utilizing social media. However, Advisors must be wary of the SEC’s “suitability” and “privacy” requirements, as well as Rule 2210, which governs communications with the public generally. Furthermore, there also are general record-keeping requirements implied by the Securities Exchange Act of 1934 — or that are imposed by that act with Rules 17a-3 and 17a-4, and also by NASD Rule 3110. Communications through social media probably fall under these rules. Supervisory responsibilities are also implicated.



In general, the most recent SEC alert is “not intended as a comprehensive summary of all compliance matters pertaining to the use of social media by RIAs. Rather, it discusses measures that may assist RIAs in designing reasonable procedures designed to prevent violations of the Advisers Act and other federal securities laws with respect to firm, investment advisory representative (“IAR”) and solicitor (employees or third parties that solicit or “find” new advisory clients) use of social media.”

Along these lines, the SEC alert provides a non-exhaustive list of factors for RIAs to consider when evaluating the effectiveness of their compliance programs with respect to the use of social media.

This list may be found [here](#).

Third Party Postings

Some firms allow third parties to post messages, forward links, and post articles on the firms’ social media sites, while other firms have explicit policies limiting third-party use to “one way postings,” where the firms’ IARs or solicitors post on the firms’ social media sites but do not interact with third parties or respond to third-party postings. More conservatively, some firms limit third-party postings to authorized users and prohibit postings by the general public. Many firms post disclaimers directly on their site stating that they do not approve or endorse any third-party communications posted on their site in an attempt to avoid having a third-party posting attributed to the firm.

The SEC's alert suggests that firms that allow for third-party postings have policies and procedures concerning third-party postings, including testimonials about the firm or its IARs as well as reasonable safeguards in place to avoid any violation of the federal securities laws.



Note that the SEC believes that, depending on the facts and circumstances, the use of “social plug-ins” such as Facebook’s “like” button could be a testimonial under the Advisers Act.

Recordkeeping Responsibilities

The alert also warns firms that the social media use by the firm and its IARs and solicitors can also trigger record-keeping requirements. Under the Advisers Act, the recordkeeping obligation does not differentiate between various media, including paper and electronic communications, such as e-mails, instant messages, and other Internet communications that relate to the Advisor's recommendations or advice. RIAs that communicate through social media must retain records of those communications if they contain information that satisfies an investment adviser's recordkeeping obligations under the Advisers Act. In the SEC's view the content of the communication is determinative. Consequently, a firm that intends to communicate, or permit its IARs to communicate, through social media sites should determine that it can retain all required records related to social media communications and make them available for inspection.

Bottom Line

This is far from the last word on the use of social media by RIAs and broker-dealers. Individual Advisors and firms need to recognize that while the media is new, the SEC's general approach is that the old rules apply. It doesn't matter what the form of the media, in the SEC's view, misconduct is misconduct.

Regulation, Compliance, and similar topics are covered in great detail in many of Cannon's professional development solutions. To find out more visit: www.cannonfinancial.com.

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