FS Regulatory Brief

SEC Staff Provides Guidance on the Use of Social Media by Advisers

Introduction

Reflecting the fact that many registered investment advisers and their personnel use social media in various forms to communicate with existing and potential clients and to promote their services, the SEC staff recently issued a *National Examination Risk Alert* ("Risk Alert") providing suggestions for complying with the antifraud, compliance, and recordkeeping provisions of the federal securities laws.[1]

This is the first time that the SEC staff has provided guidance concerning the use of social media by advisers. The growing use of social media, and the compliance challenges it presents, has been top-of-mind for registrants and compliance professionals. Indeed, FINRA recently provided guidance for its broker-dealer members on the use of social media and its compliance and supervisory challenges.[2]

While many investment advisers have adopted written policies and procedures addressing social media use, this Risk Alert sets forth a number of specific factors that the SEC staff believes should be considered if and when an adviser and its personnel are permitted to use social media.

The SEC's Risk Alert is likely based on observations made during an SEC sweep conducted in late 2010 that evaluated the use of social media by advisers of varying sizes and strategies. The SEC released the Risk Alert at the same time it charged an Illinois-based registered adviser with making fraudulent statements on various social media websites.

All SEC-registered advisers (and those preparing to register) should carefully review the SEC's Risk Alert and consider the SEC staff's recommendations in light of their existing policies, procedures and controls. In addition, while the Risk Alert is directed towards SEC-registered advisers, other advisory firms may find it helpful in identifying practices and controls as well.

This FS Regulatory Brief summarizes elements of the guidance and suggests some specific actions that investment advisers may wish to consider as they review their policies and procedures in this area. We strongly recommended that the Risk Alert be reviewed in its entirety.

In this FS Regulatory Brief, we also discuss the definition of "social media," compliance program considerations, third party content and recordkeeping responsibilities, and provide some points for advisers to consider in this area.

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[1] This *National Examination Risk Alert* was issued by staff of the SEC's Office of Compliance Inspections and Examinations (OCIE) in coordination with other SEC staff from the Division of Enforcement's Asset Management Unit and the Division of Investment Management. The Alert can be found at http://sec.gov/about/offices/ocie/riskalert-socialmedia.pdf

[2] *See* FINRA Regulatory Notice 11-39 (Aug. 2011) and FINRA Regulatory Notice 10-06 (Jan. 2010).

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What is "social media?"

Although reduced to only a footnote in the Risk Alert, the SEC staff broadly defines social media as:

> "an umbrella term that encompasses various activities that integrate technology, social interaction and content creation. Social media may use many technologies, including, but not limited to, blogs, microblogs, wikis, photos and video sharing, podcasts, social networking, and virtual worlds."

This may be a more expansive definition of social media than many firms currently use when defining this concept for the purposes of developing their policies and procedures. For example, advisers may not now include wikis, photos, videos or virtual worlds in their policies. Advisers should critically reassess what types of activities they have identified as social media in light of this broad definition. It is possible that investment adviser personnel may use media that have historically not been included in an adviser's definition of social media but should be - based on the staff's current definition.

Compliance program considerations

The SEC staff notes that, as with designing any aspect of an effective compliance program, a firm should first identify the risks that are unique to that firm's use of social media before building or enhancing compliance controls. While many firms have policies and procedures that apply to the use of social media, the staff noted that many firms have overlapping policies and procedures that apply to advertising, client communications or electronic communications in general, and that may or may not specifically include social media. The staff believes that this lack of specificity may cause confusion as to which standards and procedures apply to the use of social media.

The staff provides a list of thirteen factors to be considered by advisers in their compliance programs around social media, but cautions that the list is not exhaustive and that other factors not included could be equally relevant. Some of the factors that, in our view, are particularly important to consider, are described below.

Prior to making revisions to policies or procedures, advisers should: 1) conduct a holistic review of how social media policies and procedures impact their existing policies and procedures; and 2) ensure that social media policies and procedures are specific to the risks that the adviser's social media usage presents.

Usage guidelines/content standards

The Risk Alert suggests that advisers should consider establishing clear guidelines for the appropriate use of social media by the firm, its employees, and any hired consultants or solicitors acting on the firm's behalf. These usage guidelines should include content standards. A firm may chose to limit the types of websites, blogs, wiki sites etc., that it allows for business related social media usage. While some advisers may have an evolved firm social media platform used by various departments within the organization (e.g., recruiting, business development, investor relations, client services) others may choose to prohibit social media use altogether. Certain advisers utilize technological restrictions that prohibit access to third-party websites via the firm's network.

An adviser also should consider whether to allow firm-related business to be conducted on non-firm sponsored/third-party social media websites and what types of activities are acceptable. The SEC staff suggests that while posting biographical information on a third party website may be deemed appropriate by the adviser, the adviser may also choose to prohibit conducting business through the site.

Advisers should give careful thought to the type of content that is created via social media and if that content in any way complicates or could complicate the adviser's fiduciary or regulatory obligations (e.g., providing investment recommendations, information on

specific investment services, investment performance or client testimonials).

Information posted on social media sites should be consistent with the firm's own website and existing marketing materials. All information posted or disseminated on a social media website (proprietary or third-party) should be considered public.

Pre-approval

The Risk Alert suggests that pre-approval requirements could be implemented for: 1) the content to be posted and/or disseminated; 2) specific personnel permitted to use social media; 3) the social media sites approved for use; and 4) the functionality to be used. For example, some advisers may determine to require employees to submit personal biographical information for pre-approval or require employees to request approval prior to joining industry groups or topic specific chat rooms. Alternatively, advisers may also decide to use a single, standard firm description for social media sites.

Instituting a pre-approval regime may increase awareness around the requirements of the adviser's social media policies and, as a result, lead employees to assess the risks associated with social media on their own. In addition, pre-approval provides compliance supervisors an opportunity to evaluate the content, personnel, sites, and other issues prior to use. A pre-approval regime for each communication, however, may be resource intensive and unwieldy for certain consistent or common uses of social media.

Monitoring

The SEC staff suggests that when deciding on its social media policy, an adviser may wish to consider whether it has the appropriate resources to monitor the activities it permits. Advisers may consider whether monitoring should be executed by a single business unit (e.g., compliance, internal audit, risk) or by individual business managers. Each adviser should assess its existing supervisory structure to determine the appropriate approach.

In addition, the staff suggests that the frequency of monitoring could be on a risk-based approach, stating that this determination could depend on the volume and pace of the communications, the nature of the communications and the probability that they could mislead. While suggesting a risk-based approach, the Risk Alert cautions that:

> "The after-the fact review of violative content days after it was posted on a firm's social networking site, depending on the circumstances, may not be reasonable, particularly where social media content can be rapidly and broadly disseminated to investors and the markets."

Before deciding whether to allow the use of social media, firms should evaluate whether they wish to direct the significant resources required to monitor its use. As with other aspects of an adviser's compliance program, the use of a third-party service provider to assist with monitoring could be effective. However, advisers should be cautious as the ultimate responsibility resides with the adviser. In addition, significant caution should be used when designing a monitoring program, in light of the risks in this area.

Training and certification

The Risk Alert suggests that firms consider implementing training related to social media that seeks to promote compliance and to prevent potential violations of the federal securities laws and the firm's internal policies, and to consider requiring a certification by employees and advisory solicitors confirming that those individuals understand and are complying with the firm's social media policies and procedures.

Training on social media policies and procedures can be an important tool to facilitate understanding of the firm's usage standards, content guidelines and certifications required for social media use. It may also serve as a reminder regarding the distinction (if an adviser chooses to make one) between social media for business versus personal use.

As with all training, the timing is important. The implementation of new or amended policies and procedures should be accompanied by training sessions in which employees have the opportunity to ask questions. Real life examples should be employed as much as possible to eliminate ambiguity. When in doubt, adviser personnel should be encouraged to consult with compliance and legal departments when they have questions.

While not recommended for use as a stand-alone compliance tool, advisers may find individual employee certifications to be an important component of a larger set of effective controls around social media use. Certifications could be included in the initial compliance training and as part of the quarterly or annual reporting requirements. Certifications can be tailored to specific sub-groups of employees.

Third party content

The Risk Alert also discusses advisers' practices with regard to third-party content. The SEC staff recommended that firms who permit third-party postings should consider having policies and procedures concerning third-party postings, including the posting of testimonials about the firm or its representatives, as well as reasonable safeguards to avoid any violation of the federal securities laws.

According to the staff, most firms allow third parties to make postings on their social media sites, but the procedures governing such third-party postings vary in terms of what types of postings are permissible. Some firms permit 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' representatives or solicitors post on the firms' social media sites but do not interact with third parties or respond to third-party postings. 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.

Advisers should review their policies and procedures with respect to third-party content and in light of the risk that third-party communications posted on a firm's site could be attributed to the firm.

The Risk Alert then discusses circumstances in which a third-party statement may be considered a testimonial. Noting that the term "testimonial" is not defined in SEC rules, the staff stated it interprets that term to include "*a statement of a client's experience with, or endorsement of, an investment adviser.*"

Although whether a third-party statement is a testimonial depends on all facts and circumstances, the SEC staff stated its view that the use of "social plug-ins" such as the "like" button could be considered a testimonial under the Investment Advisers Act of 1940 ("Advisers Act").[3] The staff further explained that third-party use of the "like" feature on an investment adviser's social media site could be deemed to be a testimonial prohibited by Rule 206(4)-1(a)(1)[4] if it is an explicit or implicit statement of a client's or clients' experience with an investment adviser or its representative.

The staff noted that some social media sites do not permit an investment adviser to disable the "like" (or similar feature), which may require an adviser to develop a system to monitor and, if necessary, remove third-party postings. Given the staff's reference, firms should review which social media sites they permit use of in order to ensure that the "like" feature can be disabled, and if not, consider ceasing to use the site(s).

[3] 15 U.S.C. § 80b-1 *et seq.*

[4] 17 C.F.R. § 275.206(4)-1(a)(1).

Recordkeeping

The SEC staff also set forth its views on recordkeeping and production requirements of required records generated by social media communications.
Notably, the staff states quite clearly that the recordkeeping obligation under the Advisers Act (Rule 204-2): [5]

> "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 advisers' recommendations or advice. [Advisers] . . . 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 staff's view the content of the communication is determinative."

How to comply

The staff made several recommendations as to how a firm may meet its recordkeeping obligations. First, the staff suggested that an adviser that intends to use social media or allow its representatives to communicate through social media sites "may want to" determine whether it has the ability to retain all required records related to social media communications and make them available for SEC staff inspection.[6]

The staff then recommended that advisers may want to consider adopting compliance policies and procedures that address (if relevant) the following factors:

- Determining, among other things:
  - whether each social media communication used is a required record, and, if so,
  - the applicable retention period, and
  - the accessibility of the records.
- Maintaining social media communications in electronic or paper format (e.g., screen print or pdf of social media page, if practicable).
- Conducting employee training programs to educate advisory personnel about recordkeeping provisions.
- Arranging and indexing social media communications that are required records and kept in an electronic format to promote easy location, access and retrieval of a particular record.
- Periodic test checking (using key word searches or otherwise) to ascertain whether employees are complying with the compliance policies and procedures (e.g., whether employees are improperly destroying required records).
- Using third parties to keep records consistent with the recordkeeping requirements.

Before deciding whether to allow the use of social media, firms should evaluate whether they wish to direct the significant resources required to monitor, store, save and retrieve communications. Firms that currently use social media should assess their current recordkeeping policies and procedures—and practices—to determine the content of communications and how records need to be maintained as a result. This could present a need for increased data storage capabilities.

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[5] *Id.* at § 275.204-2.
[6] Note that while issuing this alert, the SEC simultaneously brought an enforcement action against an adviser alleging, among other things, that it violated Section 204 of the Advisers Act and Rules 204-2(a)(11) and 204-2(e)(3)(i) thereunder by: (a) failing to make and maintain required records relating to its advisory business; and (b) failing to establish procedures to preserve required electronic records, such as email, "so as to reasonably safeguard them from loss, alteration, or destruction" and to maintain those records in a manner that "permits easy location, access and retrieval of any particular record."

Points to consider

While the Risk Alert provides useful guidance, it also highlights the SEC's message that advisers should ensure that they are in compliance with all applicable regulatory requirements and be aware of the risks associated with using various forms of social media.

Before deciding whether and how to allow the use of social media, firms should evaluate whether they wish to allocate the significant resources required to ensure that the risks are mitigated.

If an adviser permits social media for business use, conduct a top to bottom comprehensive review.

Advisers should evaluate their written policies and procedures in light of this Risk Alert and assess whether any changes should be made. We recommend that advisers conduct this review as soon as practicable.

Consider each point of the SEC staff's guidance and how it would apply.

While the staff stated that the Risk Alert does not present an exhaustive checklist for social media policies and procedures, investment advisers should nonetheless evaluate their own policies, procedures and practices in light of each item, while considering the overall risk that social media activities present.

Evaluate your definition of social media against the SEC staff's expansive interpretation and close any potential gaps.

Part of that process may be to identify which social media mediums (e.g., blogs, technologies, sites, services) the firm believes are appropriate for business purposes. Firms may determine to permit some mediums for personal use only.

Additional information

If you would like additional information about the topic discussed in this FS Regulatory Brief, please contact:

Lori Richards, Principal	lori.richards@us.pwc.com	703 610 7513
Robert Nisi, Managing Director	robert.nisi@us.pwc.com	415 498 7169
Anthony Conte, Managing Director	anthony.conte@us.pwc.com	646 471 2898
Jon Kropf, Director	jonathan.kropf@us.pwc.com	415 730 6254

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