



# THE GUIDE TO SOCIAL MEDIA AND THE SECURITIES LAWS

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## INTRODUCTION

The growing use of social media has created challenges for federal securities regulators, who must enforce antifraud rules that were written at a time when the prevailing technology was the newspaper.

This Guide summarizes how federal regulation of securities has evolved in the face of the growing use of social media by investors, securities issuers, broker-dealers, investment advisers and investment companies. Given the fast pace of changes, this Guide is a work in progress.

## REGULATION FD

Beginning in 1999 and continuing into 2000, media reports about selective disclosure of material nonpublic information by issuers raised concerns that select market professionals who were privy to this information profited at the expense of others. A consensus began to emerge that selective disclosure (1) adversely affects market integrity (to a similar extent as does insider trading) and (2) allows issuers to use nonpublic information unfairly to gain favor with analysts or investors.<sup>1</sup>

In response to the perceived threat presented by selective disclosure of material nonpublic information by issuers, the Securities and Exchange Commission (SEC) adopted Regulation Fair Disclosure (“Regulation FD”) in 2000. Regulation FD requires an issuer that discloses material nonpublic information to certain individuals (generally holders of the issuer’s securities and securities market professionals) to also make the information publicly available. The required timing of the public disclosure depends on whether the issuer selectively disclosed the information intentionally. If the issuer made the selective disclosure intentionally, the issuer must simultaneously present the material to the public. If the issuer made the selective disclosure unintentionally, it must promptly disclose the information to the public.

Regulation FD provides that a person acting on behalf of a company can be (1) any senior official of the issuer or (2) any other officer, employee or agent of an issuer who regularly communicates with any of the enumerated persons described in Regulation FD (generally thought

to include directors, senior officers, investor relations and public relations officers, or people who perform similar functions, as well as any other agents or employees of a company who regularly communicate with company investors and market professionals). Regulation FD also extends to any employee who has been directed to make a selective disclosure by a member of senior management. If a noncovered employee makes selective disclosure, and if that employee has been directed to make the selective disclosure by a senior official, then the senior official would be held responsible for the selective disclosure.

The question of who is a “covered person” for Regulation FD purposes is important from a social media perspective because those within a company who are responsible for social media communications may not be the most senior executives in the company and may have a role that is different from the role of traditional investor relations professionals. Here’s a principal concern: An employee responsible for tweeting, or posting on Facebook, or providing information through another social media outlet, may not be a senior official or person who generally communicates with the company’s investors or market professionals. Nonetheless, Regulation FD’s requirements may apply when the employee is handling and communicating material nonpublic information about the company.

Moreover, covered persons must carefully consider whether statements made through social media would be considered personal to the individual and not subject to regulation, or statements attributable to the company.

### Determining If Information Posted on a Website Is Public

Regulation FD effectively requires issuers to consider whether they adequately disseminate information to the public. When the SEC adopted Regulation FD in 2000, it indicated that public disclosure “may be made by filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, nonexclusionary distribution of the information to the public.”<sup>2</sup>

Since then, issuers have disclosed significantly more information on their websites.<sup>3</sup> In 2000, the SEC stopped short of stating that it considered disclosure on

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<sup>1</sup> *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716 (Aug. 24, 2000), available at <http://www.gpo.gov/fdsys/pkg/FR-2000-08-24/pdf/00-21156.pdf>.

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<sup>2</sup> *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,716.

<sup>3</sup> *Commission Guidance on the Use of Company Web Sites*, 73 Fed. Reg. 45,862 (Aug. 7, 2008), available at <http://www.gpo.gov/fdsys/pkg/FR-2008-08-07/pdf/E8-18148.pdf>.

a company's website to be adequate public dissemination.<sup>4</sup> At the time, the SEC indicated that "[a]s technology evolves and as more investors have access to and use the Internet," the SEC might consider a website posting to meet the public disclosure requirements of Regulation FD.<sup>5</sup> In 2008, the SEC addressed the issue in an interpretive release providing guidance as to whether information on a company's website could be considered a sufficient means of public disclosure for the purposes of Regulation FD. The SEC determined that when a company is evaluating if information posted on its website is public or not, the company must consider whether:

- a company website is a recognized channel of distribution;
- posting of information on a company website disseminates the information in a manner making it available to the securities marketplace in general; and
- there has been a reasonable waiting period for investors and the market to react to the posted information.<sup>6</sup>

In determining whether a company's website is a recognized channel of distribution, the analysis focuses on what the company has done to notify investors and the market of its website and disclosure policy. The SEC indicated that steps a company can take to establish its website as a recognized channel for disclosing information include:

- listing a company's website address on periodic reports and press releases;
- establishing a pattern of posting important information on its website; and
- informing investors that they can find important information about the company on its website.

In evaluating whether the posting of information on a company website disseminates the information in a manner making it available to the public in general, the SEC indicated that companies should focus on the manner in which the information is posted on a company's website and the accessibility of such information. Questions that a company should consider include:

- Is the website designed to effectively direct visitors to important information?
- Is information for investors prominently displayed on the website?
- Do the media regularly pick up and report information posted on the company's website?

The SEC also noted that a company can also improve the accessibility of information on its website by utilizing "push" technology. Push technology is a type of communication that originates with a publisher of the information, such as an RSS feed, in contrast to the concept of a "pull" communication, which originates with the consumer of information.

In determining if there has been a reasonable waiting period for investors to react to information posted on a company's website, the SEC indicated that the analysis depends on the circumstances of the dissemination. For a website, this means evaluating the traffic that the site generates, how often investor-specific information is accessed and the complexity of the information presented. For example, simple information posted on a website with heavy traffic that is routinely used by investors would likely be considered disseminated to the public sooner than complex information that is posted on a website with little traffic and that is not routinely used by investors.

Rule 101(e) of Regulation FD specifies that the filing or furnishing of information on a Form 8-K is sufficient to make the information public for the purposes of Regulation FD, notwithstanding any other efforts on the part of a company to utilize some broad, nonexclusionary means to disseminate that information. In public forums, the SEC Staff has indicated that an effective model for accomplishing the dissemination of information in a Regulation FD-compliant manner, at least with earnings announcements, would be to first furnish to the SEC an earnings release with an Item 2.02 Form 8-K, and then, following confirmation of the appearance of the filing on EDGAR, proceed with website posting of the earnings release.

The factors for determining if information has been adequately disseminated to the public for the purposes of Regulation FD are equally applicable for determining if information is publicly available for antifraud purposes.<sup>7</sup> For example, a potential plaintiff or the SEC

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<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

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<sup>7</sup> Listed public companies also must consider stock exchange guidelines on the release and dissemination of information. Both the New York Stock Exchange and NASDAQ have policies that require

would likely not be able to successfully allege that material nonpublic information had not been adequately disclosed to the market in the course of trading by a company in its own securities if the company had taken the necessary steps discussed above to disseminate the information.

To facilitate an ongoing determination that a company's website is a recognized channel of distribution of material information concerning the company, it is suggested that the company take the following steps:

- In all company communications to investors, include a statement that the company routinely posts all important information about the company on its website and include a reference to the URL of the company's website.
- Consider including a separate means to access the Investor Relations pages of the company's website from the main page of the website so that it is more readily apparent where investors may locate important information about the company that is posted on the company's website.
- Monitor the dissemination of information to determine the extent to which information reaches intended audiences and the extent to which persons access the company's website for material information about the company.

### SEC Guidance on the Use of Social Media

As companies rely more heavily on social media, a critical question is whether public dissemination of information through social media is adequate for purposes of compliance with Regulation FD.

In a Report of Investigation under Section 21(a) published on April 2, 2013, the SEC said that social media channels—such as Twitter and Facebook—could be used by public companies to disseminate material information, without running afoul of Regulation FD.<sup>8</sup> The SEC emphasized that companies should apply the guidance from its 2008 interpretive release regarding the disclosure of material information on company websites when analyzing whether a social media channel is in fact a “recognized channel of distribution,”

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prompt release of material nonpublic information to the public in a manner that is compliant with Regulation FD.

<sup>8</sup> *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings*, Release No. 34-69279 (April 2, 2013) (the “21(a) Report”), available at <https://www.sec.gov/litigation/investreport/34-69279.pdf>.

including the guidance that investors must be provided with appropriate notice of the specific channels that a company will use to disseminate material nonpublic information.

Section 21(a) of the Exchange Act authorizes the SEC to investigate violations of the federal securities laws and, in its discretion, “to publish information concerning any such violations.” Section 21(a) Reports do not represent an adjudication of the facts or issues addressed. Rather, they express the SEC's views regarding the matters discussed in the report. Because the Section 21(a) Report describes the views of the SEC, it can serve as authoritative interpretive guidance on the matters discussed, much like an SEC interpretive release. In the course of an investigation of a potential Regulation FD violation arising from a CEO's Facebook post, the SEC Staff learned that there was uncertainty as to how the 2008 Guidance should apply in the context of releasing information through social media channels, so the SEC determined that the 21(a) Report would serve as a vehicle for communicating how to apply Regulation FD and the 2008 Guidance to communications made through social media channels. The SEC did not initiate an enforcement action or allege wrongdoing in connection with issuing the 21(a) Report.

The SEC confirmed in the 21(a) Report that Regulation FD applies to social media and other emerging means of communication used by public companies in the same way that it applies to company websites as discussed in the 2008 Guidance, which clarified that websites can serve as an effective means for disseminating information if investors have been made aware that they can locate the company information on the website.

The 21(a) Report indicates that, while every situation must be evaluated on its own facts, disclosure of material nonpublic information on the personal social media site of an individual corporate officer, without advance notice to investors that the social media site may be used for this purpose, is unlikely to qualify as an acceptable method of disclosure under securities laws. In this regard, the SEC notes that it would not normally be assumed that the personal social media sites of public company employees would serve as channels through which the company discloses material nonpublic information.

The SEC acknowledges in the 21(a) Report that the ways in which companies may use social media channels are not fundamentally different from the ways in which the websites, blogs and RSS feeds addressed by the 2008 Guidance are used. In revisiting the 2008 Guidance in the context of social media channels, the SEC notes that the 2008 Guidance was designed to be flexible and adaptive, and therefore provides issuers “with a factor-



based framework for analysis, rather than static rules applicable only to web sites.” In analyzing whether a website is a recognized channel of distribution, the SEC notes:

The central focus of this inquiry is whether the company has made investors, the market, and the media aware of the channels of distribution it expects to use, so these parties know where to look for disclosures of material information about the company or what they need to do to be in a position to receive this information.

In analyzing how Regulation FD applies to any communication, the SEC notes that while the Regulation FD adopting release highlighted concerns about “selective” disclosure of information to favored analysts or investors, “the identification of the enumerated persons within Regulation FD is inclusive, and the prohibition does not turn on an intent or motive of favoritism.” The SEC also emphasizes that nothing in Regulation FD suggests that disclosure of material nonpublic information to a broader group that includes *both* enumerated and nonenumerated persons, but that still would not constitute a public disclosure, would somehow result in Regulation FD being inapplicable. Rather, the SEC states that “the rule makes clear that public disclosure of material nonpublic information must be made in a manner that conforms with Regulation FD whenever such information is disclosed to any group that includes one or more enumerated persons.” As a result, whenever a company discloses information to enumerated persons, including to a broader group of recipients through a social media channel, the company must consider whether that disclosure implicates Regulation FD. Issuers should determine, for example, whether the disclosure includes material nonpublic information and whether the information was being disseminated in a manner “reasonably designed to provide broad, nonexclusionary distribution of the information to the public” in the event that the issuer did not choose to file a Form 8-K.

Drawing on the reference to “push” technologies (such as email alerts, RSS feeds and interactive communication tools, such as blogs) in the 2008 Guidance, the SEC acknowledged that social media channels are an extension of these concepts, and therefore the guidance should apply equally in the context of social media channels. Given the “direct and immediate communication” possible through social media channels, such as Facebook and Twitter, the SEC expects companies to examine whether such channels are recognized channels of distribution. In particular, the SEC emphasized the need to take steps to alert the market about which forms of communication a company

intends to use for the dissemination of material nonpublic information. The SEC notes that without this sort of notice, the investing public would have to keep pace with a “changing and expanding universe of potential disclosure channels.” The ways in which such notice could be provided would include (1) references in periodic reports and press releases to the corporate website and disclosures that the company routinely posts important information on that website and (2) disclosures on corporate websites identifying the specific social media channels a company intends to use for the dissemination of material nonpublic information (thereby giving people the opportunity to subscribe to, join, register for or review that particular channel).

In light of the SEC’s guidance, companies should consider whether to specifically address the use of social media in their Regulation FD policies, including whether prohibitions, restrictions or editorial oversight should be implemented to govern the use of social media by those persons authorized to speak for the company. This area is still evolving and should be continuously monitored, as the methods for interacting with shareholders, analysts and others continue to evolve.

As with the 2008 Guidance, companies may not be able to implement the 21(a) Report’s guidance to eliminate more traditional forms of public dissemination. But the guidance may provide more comfort for companies using social media to supplement other more traditional forms of communication. Companies should carefully evaluate which social media channels may be useful for communicating information and begin providing notice to investors in the company’s filings that information about the company may be found on those social media channels, while using those channels as a regular source of information. At the same time, companies should advise individual officers, directors and employees that posting information about the company on social media channels could potentially implicate Regulation FD, and therefore such persons must exercise caution when communicating through social media.

## FORWARD-LOOKING STATEMENTS

Issuers often include forward-looking information, such as estimates, projections, plans and beliefs regarding future performance in their required public filings. Section 27A of the Securities Act of 1933 (the “Securities Act”) and the Exchange Act provide a safe harbor from liability for forward-looking statements if a statement is:

- identified as a forward-looking statement; and
- accompanied by meaningful cautionary statements

identifying important factors that could cause actual results to differ materially from the forward-looking statement.

Twitter's 140-character limit, for example, may present challenges for issuers seeking to rely on the safe harbor for forward-looking statements. This limit is hardly enough space to accommodate the statement itself, let alone language identifying the statement as forward-looking and cautioning the reader as to potential factors that could cause actual results to differ materially from the forward-looking statement. Some companies have attempted to address the problem by posting multiple-tweet disclaimers before tweeting presentations that include forward-looking information. Other companies have sought to address this concern by linking to a web page, SEC report or press release where information about the forward-looking statements is provided in full. It remains uncertain whether a court would determine that either of these methods provides a means by which the forward-looking statements are identified and are accompanied by meaningful cautionary statements.

### **NONGAAP MEASURES**

Issuers should consider Regulation G, which requires issuers to reconcile nonGAAP financial information to a comparable GAAP financial measure, when publishing financial performance in social media. Similar to the approach taken with forward-looking statements discussed above, issuers providing nonGAAP financial information through Twitter have used multiple tweets in order to include the necessary accompanying disclosure required by Regulation G, or have provided links to where the reconciliation information is provided elsewhere. As with forward-looking statements, there is a threat that posts such as these will be taken out of context or only partially retweeted (resulting in a communication that may not be considered fully compliant with Regulation G).

### **ADOPTION OF OR ENTANGLEMENT WITH THIRD-PARTY STATEMENTS**

The SEC has generally taken the view that a company is not responsible for statements that third parties post on a company-sponsored website, nor does a company have any obligation to correct a misstatement made by a third party. A company can be held liable for third-party information to which it hyperlinks from its website and that could be attributable to the company through concepts of entanglement or adoption.

Chief among a company's concerns in adopting or being entangled with the statements of another is that the

statements could be deemed misleading under the federal securities laws and as a result the company could be deemed liable for the statement. Issuers should therefore be careful when referencing, and especially when linking to, online content that they do not control. Particular care should be taken when linking to content that may change after the link is posted, as even diligent monitoring cannot ensure that a member of the public will not follow the link and find materially misleading information. Moreover, activity such as "friending" a securities research analyst on Facebook or tweeting an analyst's handle on Twitter—as well as retweeting an analyst's tweet about the company—could potentially be construed as adoption of the analyst's past and future statements about a company or its securities.

### **LIABILITY FOR MISSTATEMENTS AND OMISSIONS**

Electronic communications, including through social media websites, can create risks due to the rapid and often informal nature of the communications. However, given the potential liability for a material misstatement or omission in public communications, companies and their counsel are well-advised to treat any statements by or on behalf of the company made through social media websites with the same care that is used when evaluating disclosures included in SEC reports and press releases.

### **SECURITIES OFFERING COMMUNICATIONS**

The SEC Staff has provided guidance on applying its rules regarding communications in connection with securities offerings. The Staff's guidance permits the use of a hyperlink to information required by certain rules when a character- or text-limited social media channel such as Twitter is used for a regulated communication, and also confirms that a communication that has been retransmitted by a third party that is not an offering participant or someone acting on behalf of the issuer is not attributable to the issuer for the purposes of the rules that apply to such communication.

#### **Rule 134 Notices**

Rule 134 under the Securities Act permits an issuer conducting a registered securities offering to make limited communications that will not be deemed to be a prospectus or free writing prospectus, provided that the communication includes no more information than is permitted by the rule and the communication includes specific legends, including the statement required by Rule 134(b)(1) and information required by Rule 134(b)(2), unless the conditions of Rule 134(c) are met, as well as the statement required by Rule 134(d) if the communication solicits from a recipient an offer to buy the security or

requests the recipient to indicate whether he or she might be interested in the security.

Rule 134(b)(1) provides that if the registration statement has not yet become effective, the following statement must be included:

A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective.

Rule 134(b)(2) indicates that the notice must include the name and address of a person or persons from whom a written prospectus for the offering, meeting the requirements of Section 10 of the Securities Act, other than a free writing prospectus, including a price range where required, may be obtained.

Rule 134(d) provides that a communication sent or delivered to any person that is accompanied or preceded by a prospectus that meets the requirements of Section 10 of the Securities Act (other than a free writing prospectus), including a price range where required, at the date of such communication, may solicit from the recipient of the communication an offer to buy the security or request the recipient to indicate whether he or she might be interested in the security, if the communication contains substantially the following statement:

No offer to buy the securities can be accepted and no part of the purchase price can be received until the registration statement has become effective, and any such offer may be withdrawn or revoked, without obligation or commitment of any kind, at any time prior to notice of its acceptance given after the effective date.

Recognizing the growing interest in the use of social media, in Securities Act Rules Compliance and Disclosure Interpretations Question 110.01, the Staff indicates that it would not object to the use of an active hyperlink to satisfy the requirements of Rule 134(b) and Rule 134(d) in limited circumstances when:

- The electronic communication is distributed through a platform that has technological limitations on the number of characters or amount of text that may be included in the communication;
- The inclusion of the entire required statements, together with the other information in the communication, would cause the communication to

exceed the limit on the number of characters or amount of text; and

- The communication contains an active hyperlink to the required statements and prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink.

The Staff points out that when an electronic communication is capable of actually including the required statements, along with the other information, without exceeding a limit on the number of characters or amount of text, then the use of the hyperlink would not be appropriate. Therefore, the guidance appears to be limited to those micro-blogging social media channels with character or text limitations such as Twitter, rather than other social media channels, such as Facebook, which permit longer postings.

The Staff took a similar approach in Securities Act Rules Compliance and Disclosure Interpretations Question 232.15,<sup>9</sup> which provides an interpretation with respect to Rule 433 under the Securities Act. Rule 433 provides conditions for the use of free writing prospectuses (as defined in Securities Act Rule 405), and any free writing prospectus (other than free writing prospectuses that comply with Rule 433(f)(1)) must contain the legend required by Rule 433(c)(2)(i). The Rule 433(c)(2)(i) legend states:

The issuer has filed a registration statement (including a prospectus) with the SEC for the offering to which this communication relates. Before you invest, you should read the prospectus in that registration statement and other documents the issuer has filed with the SEC for more complete information about the issuer and this offering. You may get these documents for free by visiting EDGAR on the SEC Web site at [www.sec.gov](http://www.sec.gov). Alternatively, the issuer, any underwriter or any dealer participating in the offering will arrange to send you the prospectus if you request it by calling toll-free 1-8[xx-xxx-xxxx].

The legend also may provide an email address at which the documents can be requested and may indicate that the documents also are available by accessing the issuer's website and provide the Internet address and the particular location of the documents on the website.

<sup>9</sup> *Securities Act Rules Compliance and Disclosure Interpretations* (last update Jan. 23, 2015), available at <https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

The Staff notes that, under the same conditions set forth above with respect to Rule 134, an issuer can use an active hyperlink to provide the legend required by Rule 433(c)(2)(i).

The Staff also points out, in Securities Act Rules Compliance and Disclosure Interpretations Questions 110.02 and 232.16, that an issuer does not need to ensure compliance with Rule 134 and Rule 433 for electronic communications that are retransmitted by a third party that is not an offering participant or acting on behalf of the issuer, as long as the issuer has no involvement in the third party's retransmission of the information other than having initially prepared the communication in compliance with Rule 134 or Rule 433. In this regard, the Staff confirms in the context of social media platforms the guidance that the SEC provided in Release No. 33-8591, which stated:

[W]hether information prepared and distributed by third parties that are not offering participants is attributable to an issuer or other offering participant depends upon whether the issuer or other offering participant has involved itself in the preparation of the information or explicitly or implicitly endorsed or approved the information.<sup>10</sup>

The Staff's guidance appears to be directed at situations in which an offering communication prepared in compliance with Rule 134 or Rule 433 is retweeted by a third party, or otherwise retransmitted via a similar social media channel.

### BUSINESS COMBINATION COMMUNICATIONS

The Staff guidance also addresses an analogous rule in the context of business combination transactions, Securities Act Rule 165. In Securities Act Rules Compliance and Disclosure Interpretations Question 164.02, the Staff notes that the legend required by paragraph (c)(1) of Rule 165 may be provided by use of an active hyperlink, subject to the same conditions specified for Rule 134 notices and Rule 433 free writing prospectuses discussed above.<sup>11</sup> Rule 165(c)(1) specifies that a communication made under the rule must contain a prominent legend that urges investors to read the relevant documents filed or to be filed with the SEC because they contain important information, and the

legend also must explain to investors that they can get the documents for free at the SEC's website and describe which documents are available free from the offeror.

The Staff also notes that this same interpretation applies with respect to similar legend requirements specified in Rule 14a-12 under the Exchange Act, which deals with written communications that constitute solicitations, and pre-commencement written communications in connection with tender offers that are subject to Exchange Act Rules 13e-4(c), 14d-2(b) and 14d-9(a).

### PROXY SOLICITATIONS

Many types of communications, including those made over social media, can be considered a proxy solicitation that is subject to the SEC's proxy rules. Rule 14a-1 defines "solicitation" and "solicit" to include any "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding, or revocation of a proxy." Proxy solicitations are subject to SEC requirements, including in some instances filing requirements, as well as the applicability of antifraud rules. Social media communications by a company could be deemed to be proxy solicitations, and investors may in turn communicate about issues regarding a proxy solicitation through social media outlets. Because the definition of "solicitation" is so broad, companies need to take care to avoid the appearance of a proxy solicitation in the course of their communications. This includes all communications made over social media. Even if the communication is designed to merely inform the public or does not specifically reference a proxy or the company's proxy statement, courts could still find that a communication should be deemed to be a solicitation.

Exchange Act Rule 14a-17 permits the use of electronic shareholder forums to facilitate communications within limits prescribed by the rule. Under this provision, a company that sets up or runs an electronic shareholder forum will not be liable under the federal securities laws for any statement made or information provided "by another person" on the forum. If the SEC were to take the position that social media websites such as Twitter or Facebook constitute such a forum, it would provide companies with express protection for the statements of third parties on these social media websites.

A company remains responsible for its own statements and statements made on its behalf and could also be held responsible for a third-party statement if the company takes action to adopt, endorse or approve the statement. For example, if a user tweets a false or misleading

<sup>10</sup> *Securities Offering Reform*, Release No. 33-8591 (July 19, 2005), available at <https://www.sec.gov/rules/final/33-8591.pdf>.

<sup>11</sup> *Securities Act Rules Compliance and Disclosure Interpretations* (last update Jan. 23, 2015), available at <https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.



statement about a company, and the company then tweets in a way that approves the statement through an exchange with the user, then the company could be held responsible for that statement. Rule 14a-2 provides express protection with respect to the proxy solicitation rules in the context of electronic shareholder forums, as long as the communication occurs 60 days prior to the date of the company's annual or special shareholder meeting and no proxy is sought.

### CAPITAL-RAISING CONSIDERATIONS

The use of social media for company communications can raise concerns in connection with both private and public offerings of securities. Social media communications could potentially result in impermissible general solicitation or general advertising in connection with a private offering and gun-jumping or conditioning the market in connection with public offerings. At the same time, social media may prove useful in the context of new mechanisms for raising capital, such as under the provisions relating to certain Rule 506 offerings or those for conducting exempt crowdfunding offerings contemplated by the JOBS Act.

#### Private Offerings

Many private offerings of securities are conducted under Regulation D, which provides an exemption for offerings meeting the conditions specified in the Regulation. Over time, companies have come to rely frequently on Rule 506 of Regulation D, which permits issuers to sell their securities in a private placement to an unlimited number of accredited investors, provided that issuers comply with the general requirements of Regulation D. Historically, Rule 502(c) of Regulation D prohibited the issuer or any person acting on its behalf to offer or sell securities by any form of general solicitation or general advertising, including, but not limited to, "any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and any seminar or meeting whose attendees have been invited by any general solicitation or general advertising." This prohibition on the use of general solicitation and general advertising in private offerings made in reliance on Regulation D was criticized by many market participants as anachronistic given the development of communications technologies. Title II of the Jumpstart Our Business Startups (JOBS) Act, titled "Access to Capital for Job Creators," addressed the prohibition on general solicitation by mandating that the SEC undertake rulemaking to amend Rule 506 to make the prohibition against general solicitation or general advertising contained in Rule 502 inapplicable in the context of Rule 506 offerings, provided that all

purchasers in the offering are accredited investors. Congress believed that by removing this restriction on communications, emerging companies would be able to raise capital more easily and contact investors with whom they may not have a pre-existing relationship.

The SEC adopted the required amendment in July 2013, and the amended rule became effective September 23, 2013. An issuer may now decide to rely on existing Rule 506(b) to conduct a private offering without using general solicitation or general advertising. Alternatively, an issuer may choose to rely on Rule 506(c), which permits the use of general solicitation and general advertising, subject to the following conditions:

- The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors;
- All purchasers of securities must be accredited investors, either because they fall within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they qualify as accredited investors, at the time of the sale of the securities; and
- The issuer satisfies the conditions of Rule 501 and Rules 502(a) and 502(d).

An issuer relying on Rule 506(c) must take "reasonable steps" to verify that investors are accredited investors. The Staff indicated that "reasonable efforts" to verify investor status will be an objective determination by the issuer based on the SEC's principles-based guidance. The SEC noted that, in determining whether it has taken reasonable steps to verify investor status, an issuer should consider the nature of the purchaser; the nature and amount of information about the purchaser; and the nature of the offering. The amended rule also provides a nonexclusive list of factors to consider in verifying the accredited investor status of natural persons.

In addition to the changes adopted to Rule 506, the SEC amended Rule 144A to eliminate references to "offeror" and "offeree," and, as a result, Rule 144A requires only that the securities are sold to a qualified institutional buyer, or QIB, or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB. The changes to Rule 506 and Rule 144A have no effect on the statutory private placement exemption available under Section 4(a)(2) of the Securities Act. General solicitation or general advertising cannot be used in the context of an offering exempt from registration in reliance on the Section 4(a)(2) exemption.

The relaxation of the ban on general solicitation and general advertising for certain Rule 506 offerings likely will facilitate wider use of social media in connection with private offerings. Before commencing any private offering, an issuer and its advisers should consider carefully whether the issuer will employ general solicitation, and determine the means by which the issuer intends to communicate with potential investors about a possible financing. Documentation, including engagement letters with financial intermediaries, placement agency agreements and offering memoranda, is likely to change as a result of the amended rules. An issuer will remain liable for the content of any general solicitation it makes in connection with a securities offering. As a result, issuers should consider updating their Regulation FD policies and their communications policies to ensure that they address communications made in the context of securities offerings. Also, certain types of issuers, such as private funds and their registered investment advisers, as well as commodity pools, will be subject to specific restrictions on the content of their communications.

### Public Offerings

“Gun-jumping” refers to impermissible offers of securities by companies in connection with a registered securities offering. Gun-jumping is a particular concern when companies use, or their employees use, social media during the time leading up to an initial public offering. The SEC has indicated that statements made through electronic means, such as website postings and emails, can be deemed written offers for the purposes of the communications rules under the Securities Act. Therefore, an electronic communication that relates to the issuer or its prospects may be deemed to be an offer of securities or otherwise “condition the market” for the offering, subjecting the issuer to liability for making an illegal offer of securities.

Because impermissible communications in connection with an offering can have significant consequences for the company and offering participants, social media use should be subject to special controls by companies contemplating a public offering. In some cases, companies contemplating an initial public offering stop making postings on company-sponsored Twitter accounts. Ongoing monitoring of social media communications is necessary to avoid concerns that written offers are being made other than by means of a prospectus or other permitted communications. There is close scrutiny of company websites, media outlets and other information sources in connection with the review of registration statements by the SEC.

Title I of the JOBS Act, titled “Reopening American Capital Markets to Emerging Growth Companies,”

establishes a new category of issuer, an “emerging growth company,” for which certain disclosure and other requirements will be phased in over time following a company’s initial public offering. The JOBS Act amends the Securities Act and the Exchange Act to add a definition of an “emerging growth company.” An emerging growth company is defined as an issuer with total gross revenues of less than \$1 billion (subject to inflationary adjustment by the SEC every five years) during its most recently completed fiscal year. A company remains an “emerging growth company” until the earliest of:

1. the last day of the fiscal year during which the issuer has total annual gross revenues in excess of \$1 billion (subject to inflationary indexing);
2. the last day of the issuer’s fiscal year following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act;
3. the date on which such issuer has, during the prior three-year period, issued more than \$1 billion in nonconvertible debt; or
4. the date on which the issuer is deemed a “large accelerated filer.”

An issuer will not be able to qualify as an emerging growth company if it first sold its common stock in a registered offering prior to December 8, 2011.

An emerging growth company may submit a draft registration statement to the SEC for confidential nonpublic review prior to public filing, provided that the initial confidential submission and all amendments thereto shall be publicly filed with the SEC no later than 21 days prior to the issuer’s commencement of a road show. Emerging growth companies may engage in oral or written communications with qualified institutional buyers, or QIBs, and institutional accredited investors (as defined in Rule 501 of the Securities Act) in order to gauge their interest in a proposed initial public offering either prior to or following the first filing of the registration statement. While these provisions provide increased flexibility with respect to communications for emerging growth companies prior to and after filing a registration statement for an initial public offering, the requirement that communications take place only with QIBs and institutional accredited investors substantially limits the availability of more broadly accessible social media as a means for making any such communications.

Given the relaxation of the ban on general solicitation in certain Rule 506 offerings discussed above, issuers and

their advisers also should consider the possibility that a permitted general solicitation in the context of a Rule 506(c) offering immediately preceding an initial public offering may be viewed as gun-jumping.

## Crowdfunding

Crowdfunding is an emerging source of financing that has its roots in social media. It is a concept where people pool their relatively small contributions together to fund a common enterprise. Title III of the JOBS Act, titled “Crowdfunding,” amends Section 4 of the Securities Act to add a new paragraph (6) that provides a crowdfunding exemption from registration under the Securities Act. The conditions of the crowdfunding exemption, which must be established through SEC rulemaking, are that:

- The aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, is not more than \$1,000,000;
- The aggregate amount sold to any investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, does not exceed:
  - the greater of \$2,000 or 5 percent of the annual income or net worth of the investor, as applicable, if either the annual income or the net worth of the investor is less than \$100,000; or
  - 10 percent of the annual income or net worth of an investor, as applicable, not to exceed a maximum aggregate amount sold of \$100,000, if either the annual income or net worth of the investor is equal to or more than \$100,000;
- The transaction is conducted through a broker or funding portal that complies with the requirements of the exemption; and
- The issuer complies with the requirements of the exemption.

Among the requirements for exempt crowdfunding offerings would be that an intermediary:

- registers with the SEC as a broker or a “funding portal,” as such term is defined in the amendment;
- registers with any applicable self-regulatory authority;

- provides disclosures to investors, as well as questionnaires, regarding the level of risk involved with the offerings;
- takes measures, including obtaining background checks and other actions that the SEC can specify, of officers, directors and significant shareholders;
- ensures that all offering proceeds are provided to issuers only when the amount equals or exceeds the target offering amount, and allows for cancellation of commitments to purchase in the offering;
- ensures that no investor in a 12-month period has invested in excess of the limit described above in all issuers conducting exempt crowdfunding offerings;
- takes steps to protect privacy of information;
- does not compensate promoters, finders or lead generators for providing personal identifying information of personal investors;
- prohibits insiders from having any financial interest in an issuer using that intermediary’s services; and
- meets any other requirements that the SEC may prescribe.

Issuers also must meet specific conditions in order to rely on the exemption, including that an issuer file with the SEC and provide to investors and intermediaries information about the issuer (including financial statements, which would be reviewed or audited depending on the size of the target offering amount), its officers, directors and greater than 20 percent shareholders, and risks relating to the issuer and the offering, as well as specific offering information such as the use of proceeds for the offering, the target amount for the offering, the deadline to reach the target offering amount and regular updates regarding progress in reaching the target.

The provision would prohibit issuers from advertising the terms of the exempt offering, other than to provide notices directing investors to the funding portal or broker, and would require disclosure of amounts paid to compensate solicitors promoting the offering through the channels of the broker or funding portal.

Issuers relying on the exemption would need to file with the SEC and provide to investors, no less than annually, reports of the results of operations and financial statements of the issuers as the SEC may determine is

appropriate. The SEC may also impose any other requirements that it determines appropriate.

A purchaser in a crowdfunding offering could bring an action against an issuer for rescission in accordance with Section 12(b) and Section 13 of the Securities Act, as if liability were created under Section 12(a)(2) of the Securities Act, in the event that there are material misstatements or omissions in connection with the offering.

Securities sold on an exempt basis under this provision would not be transferable by the purchaser for a one-year period beginning on the date of purchase, except in certain limited circumstances. The crowdfunding exemption would be available only for domestic issuers that are not reporting companies under the Exchange Act and that are not investment companies, or as the SEC otherwise determines is appropriate. Bad actor disqualification provisions similar to those required under Regulation A would also be required for exempt crowdfunding offerings.

Funding portals would not be subject to registration as a broker-dealer but would be subject to an alternative regulatory regime, subject to SEC and SRO (a self-regulatory organization) authority, which is, in this case, FINRA, to be determined by rulemaking at the SEC and SRO. A funding portal is defined as an intermediary for exempt crowdfunding offerings that does not:

1. offer investment advice or recommendations;
2. solicit purchases, sales or offers to buy securities offered or displayed on its website or portal;
3. compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;
4. hold, manage, possess or otherwise handle investor funds or securities; or
5. engage in other activities as the SEC may determine by rulemaking.

The provision would pre-empt state securities laws by making exempt crowdfunding securities “covered securities”; however, some state enforcement authority and notice filing requirements would be retained. State regulation of funding portals would also be pre-empted, subject to limited enforcement and examination authority.

For those issuers who are seeking to raise small amounts of capital from a broad group of investors, the

crowdfunding exemption may ultimately provide a viable alternative to current offering exemptions, given the potential that raising capital through crowdfunding over the Internet may be less costly and may provide more sources of funding. At the same time, issuers will need to weigh the ongoing costs that will arise with crowdfunding offerings, in particular the annual reporting requirement that is contemplated by the legislation. Moreover, it is not yet known how much intermediaries such as brokers and funding portals will charge issuers once SEC and SRO regulations apply to their ongoing crowdfunding operations.

### **Intrastate Crowdfunding**

A number of states have moved forward to adopt regulatory frameworks that permit crowdfunding by issuers within their states. In addition, the Staff of the Division of Corporation Finance of the SEC provided guidance in its Securities Act Rules Questions and Answers of General Applicability Questions 141.03, 141.04, and 141.05 that address Section 3(a)(11) of the Securities Act and Rule 147 under the Securities Act. Section 3(a)(11) provides an exemption from the registration requirements of the Securities Act for any security which is a part of an issue offered and sold only to persons who reside in a single state or territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such state or territory. Rule 147 under the Securities Act provides a safe harbor for offerings conducted pursuant to Section 3(a)(11), which requires that the issuer must be a resident of, and doing business in, the same state in which all offers and sales are made, and the offering may not be offered or sold to non-residents.

The SEC Staff reiterated in its guidance that Rule 147 does not prohibit general advertising or general solicitation. However, any general advertising or general solicitation must be conducted in a manner consistent with the requirement that offers made in reliance on the intrastate exemption under Section 3(a)(11) and Rule 147 be made only to persons resident in the state or territory of which the issuer is a resident. This CD&I notes that an issuer claiming an exemption under Rule 147 may use a third-party internet portal to promote an offering to residents of a single state in accordance with a state statute or regulation intended to enable crowdfunding within that state if the portal implements measures to ensure that offers of securities are made only to persons resident in the relevant state or territory. These measures must include, at a minimum: disclaimers and restrictive legends which make clear that the offering is limited to residents of the relevant state under applicable law; and limiting access to information about specific investment opportunities to persons who confirm they



are residents of the relevant state (examples of an acceptable confirmation are a representation as to residence or in-state residence information, such as a zip code or residence address).

This C&DI notes that issuers generally use their websites and social media presence to communicate in a broad and indiscriminate manner. Therefore, although the specific facts and circumstances would determine whether a particular communication is an offer of securities, using an established internet presence to issue information about specific investment opportunities would likely involve offers to residents outside the state in which the issuer does business.

## SEC GUIDANCE FOR REGISTERED INVESTMENT ADVISERS

### OCIE Compliance Concerns (2012)

The SEC's Office of Compliance Inspections and Examinations ("OCIE") published a National Examination Risk Alert, which outlines in stark terms the SEC Staff's compliance concerns on the use of social media by registered investment advisers.<sup>12</sup>

The SEC Staff has stated its view that use of social media to communicate with clients and prospective clients may implicate Rule 206(4)-1 under the Investment Advisers Act of 1940, which governs advertisements by investment advisers. This rule, in relevant part, provides that an investment adviser will violate the Investment Advisers Act's antifraud provisions if it publishes, circulates or distributes "any advertisement" that:

- refers, directly or indirectly, to "testimonials of any kind concerning the investment adviser" or the investment advice it provides;
- refers, directly or indirectly, to past specific recommendations it provides (e.g., "cherry-picking"), unless the adviser discloses a list of all recommendations, subject to certain requirements;
- represents that a graph, chart or formula, by itself, can be used to determine which securities to buy, without prescribed disclosures;
- contains a statement to the effect that a report, analysis or other service will be furnished free of

<sup>12</sup> Office of Compliance Inspections and Examinations, National Examination Risk Alert, Vol. II, Issue 1, *Investment Adviser Use of Social Media* (January 2012), available at <https://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf>.

charge, unless it is actually provided entirely free of charge without condition; or

- that contains any untrue statement of a material fact, or that is otherwise false or misleading.

The SEC defines "advertisement" broadly. "Advertisements" include any notice, circular, letter or other written communication addressed to more than one person, or any notice or announcement in any publication or by radio or television, that (1) offers analysis, report or publication concerning securities, or that is to be used in making any determination as to when to buy or sell any security; or (2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security; or (3) any other investment advisory service with regard to securities. We can reasonably conclude that it applies to all kinds of social media communications, including blogs, wikis, photo and video sharing, podcasts, social networking and virtual worlds.

OCIE's regulatory concerns can be categorized into three broad categories: compliance policies and procedures, third-party content, and recordkeeping.

First, the SEC Staff is concerned that investment adviser compliance programs may include overlapping procedures that apply to advertisements and communications but do not specifically include social media. The Staff urges investment advisers to evaluate the effectiveness of their compliance programs with respect to use of social media by the firms, investment adviser representatives or solicitors, including the following hot buttons:

- *Usage guidelines.* Compliance procedures should address appropriate usage and restrictions on use of social media, based on potential risks.
- *Content standards.* Content may implicate fiduciary duty or other regulatory issues, which procedures should address.
- *Monitoring.* Advisers should consider how to monitor use of social media by employees, representatives and solicitors, taking into consideration the lack of ability to monitor third-party sites.
- *Frequency of monitoring.* The Staff suggests a risk-based approach for frequency of monitoring of social media communications.
- *Approval of content.* Advisers should consider

preapproval of communications, rather than after-the-fact reviews.

- *Firm resources.* Does the adviser have sufficient resources to adequately monitor personnel?
- *Criteria for approving participation.* Compliance procedures should assess risks to the adviser, including operational, reputational, privacy and other regulatory issues.
- *Training.* Advisers should consider implementing a training program related to social media, with a view toward promoting compliance.
- *Certification.* Consider procedures that require personnel to certify that they understand and will comply with social media policies.
- *Functionality.* Advisers should consider the functionality of social media sites approved for use, including the continuing obligation to address any upgrades or modifications.
- *Personal/professional sites.* Advisers should consider whether to adopt policies to address business conducted on personal or third-party media sites.
- *Information security.* Advisers should consider whether permitting representatives to have access to social media sites poses information security risks, and how to protect information.
- *Enterprise-wide sites.* Advisers that are part of a larger financial services or corporate enterprise might consider whether to create usage guidelines designed to prevent the advertising practices of a firmwide social media site from violations of the Advisers Act.

Second, the Staff has indicated that third-party content on social media sites presents special compliance challenges. These issues arise when third parties post messages, forward links or post articles to an adviser's website or in social media sites. Adviser representatives and solicitors generally do not interact with their third parties or respond to their postings. The Staff noted its concern about direct or indirect testimonials "of any kind," and generally it broadly construes what constitutes a testimonial. A posting by a third party that comments on an adviser's stock-picking prowess, the Staff warns, may amount to a prohibited "testimonial." Even hitting the "Like" button on an adviser's Facebook

page could be a prohibited testimonial if the thumbs-up represents an explicit or implicit statement of a client's experience with an investment adviser or its representative.

The SEC Staff's third area of concern is recordkeeping obligations of advisers. OCIE noted that the recordkeeping rules do not differentiate between traditional paper communications, like snail mail, and electronic communications, such as emails, instant messages and other ways that investment advisers provide advisory services. In other words, the federal regulators focus on the *content* of the communication, rather than its *form*. OCIE urges investment advisers to ensure that their recordkeeping policies and procedures allow advisers that use social media to comply with the recordkeeping requirements.

At the same time, the SEC published an Investor Alert, *Social Media and Investing: Avoiding Fraud*, designed to make investors aware of fraudulent investment schemes that use social media, and provides tips for checking the backgrounds of investment advisers and brokers. *An Investor Bulletin, Social Media and Investing, Understanding Your Accounts* provide tips for investors who use social media about privacy settings, security and password selection. Also on the same day, the Enforcement Division announced that the SEC charged an Illinois-based investment adviser with offering to sell fictitious securities on LinkedIn. Among other things, the Division alleged that the adviser used LinkedIn discussions to promote fictitious "bank guarantees" and "medium term notes," which generated interest from potential investors. The adviser failed to comply with recordkeeping requirements or maintain a required Code of Ethics.

The SEC's Enforcement Division noted that fraudsters are quick to adapt to new technologies to exploit them for unlawful purposes. This case suggests that the federal regulators are determined to adapt to new technologies to follow the fraud.

## Testimonials (2014)

Acknowledging the growing demand by consumers for information through social media, the Division of Investment Management set some ground rules on how investment advisers can use social media and publish advertisements that feature public commentary about them that appears on social media sites.<sup>13</sup>

Generally, advisers may refer to commentary published

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<sup>13</sup> Division of Investment Management Guidance Update No. 2014-4, *Guidance on the Testimonial Rule and Social Media*, available at <http://www.sec.gov/investment/im-guidance-2014-04.pdf>.

in social media without violating the rule prohibiting publication of client “testimonials” if the content is independently produced and the adviser has no “material connection” with the independent social media site. While not a bright line in the sand, the distinction goes a long way to clear up this murky area.

Section 206 of the Investment Advisers Act of 1940 contains broad antifraud provisions that apply to advisers. Rule 206(4)-1(a)(1) under the Advisers Act defines fraud to include “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” provided by the adviser. This is the so-called “testimonial rule.” In a 1985 no-action letter, the Staff said that the basis of the prohibition is that a “testimonial may give rise to a fraudulent or deceptive implication, or mistaken inference, that the experience of the person giving the testimonial is typical of the experience of the adviser’s clients.”

While the SEC’s rules do not define the term “testimonial,” the SEC’s Staff has indicated that public commentary made by a client endorsing an investment adviser, or a statement made by a third party about a client’s experience with the adviser, may be a testimonial for this purpose. And, as the guidance notes, whether public commentary on a social media site constitutes a testimonial depends on the facts and circumstances relating to the statement.

In the age of social media, this decades-old rule presents enormous compliance challenges for advisers whose clients rely on social media.

Over the years, the Staff, through the “no-action” process, has provided limited guidance on what constitutes a testimonial. For example, the Staff has said that publication of an article by an unbiased third party regarding an adviser’s performance, unless it includes a statement of a client’s experience with the adviser, or an endorsement of the adviser, would not violate the testimonial rule. The Staff has used this concept as the basis for its current guidance.

*Third-party commentary.* The Staff attempted to draw a line between endorsements and legitimate third-party commentary:

- Advisers may not publish public commentary on their website that is an explicit or implicit statement of a client’s experience with the adviser.
- Commentaries posted directly on the adviser’s website, blog or social media site that tout the adviser’s services are prohibited testimonials.

- Advisers will not necessarily violate the testimonial rule if they publish commentary originating from an independent social media site on their own websites or social media sites, provided:
  - The independent social media site provides content that is *independent of the investment adviser or its representative*;
  - There is no *material connection* between the independent social media site and the investment adviser or its representative that would “call into question the independence” of the independent social media site or its commentary; and
  - The investment adviser or representative *publishes all of the unedited comments* appearing on the independent social media site regarding the adviser or representative.
- Content is not “independent” if the adviser or its representative had a hand in authoring the commentary, directly or indirectly. For example, paying a client (or offering a discount to a client) for saying nice things would implicate the testimonial rule.
- Advisers may not use testimonials from independent social media sites that directly or indirectly emphasize commentary favorable to the adviser, or downplay unfavorable commentary.
- Advisers may publish commentary from an independent social media site that includes a mathematical average of the public commentary—for example, based on a ratings system that is not preordained to benefit the adviser.

*Investment adviser advertisements on independent social media sites.*

- Investment advisers may advertise on an independent social media site, provided that it is readily apparent that the advertisement is separate from the public commentary and that the receipt of advertising did not influence the selection of public commentary for publication.

*Reference to independent social media site commentary in nonsocial media advertisements.*

- In print, TV and radio ads, advisers *may* refer to the fact that third-party social media sites feature

public commentary about the adviser, but they *may not* publish any actual testimonials without implicating the testimonial rule.

*Client lists on social media sites.*

- Simply identifying contacts or friends on a social media site by itself does not implicate the testimonial rule, as long as they are not grouped in a way that suggests that they endorse the investment adviser.

*Fan and community pages.*

- A third party's creation and operation of unconnected community or fan pages generally would not implicate the testimonial rule. However, the Staff *strongly cautions* advisers and their employees that publishing content from those sites or directing user traffic to those sites if they do not meet the *no material connection* and *independence* conditions described above may implicate the testimonial rule.

*Scope of regulatory approach.* The Division of Investment Management's approach to regulating the use of social media by advisers differs markedly from the approach adopted by FINRA for broker-dealers (summarized below). While both regulators focus on the substance of the communication, rather than the format, the differences arise primarily from the nature of the regulated entity and the starting point of regulation.

For example, the Division of Investment Management focuses almost exclusively on adequacy of compliance programs and whether a particular use of social media involves a prohibited "testimonial," a concept largely absent from regulation of broker-dealers. On the other hand, FINRA focuses on suitability of a recommendation and whether a particular communication requires advance compliance approval. Both approaches require caution when a regulated entity publishes or relies on third-party content.

The Division of Investment Management's guidance moves the ball forward and will provide a starting point for chief compliance officers who are struggling to get their arms around advisers' use of social media. It may also provide an opportunity for advisers to revisit their procedures for monitoring advertising. While the guidance provides some relief for advisers who now have a better idea of the limitations to which they are subject, it also provides some compliance challenges, especially when advisers and their representatives make use of fast-paced social media to advertise.

## FINRA GUIDANCE FOR BROKER-DEALERS

On August 18, 2011, FINRA issued Regulatory Notice 11-39,<sup>14</sup> providing guidance to broker-dealer members on social networking websites and business communications. The notice updated FINRA's guidance in Regulatory Notice 10-06 from January 2010.<sup>15</sup> Regulatory Notice 10-06 provides guidance on the application of FINRA rules governing communications by FINRA member firms with the public through social media sites, and reminds member firms of certain requirements relating to those communications.<sup>16</sup>

To understand the guidance, it is important to understand the difference between static and interactive electronic communications. Since 1999, FINRA has taken the position that participation by a registered representative of a member firm in an Internet chat room is comparable to a presentation made to a group of investors and, accordingly, is subject to the same rules applicable to presentations. This position was codified in 2003 when NASD Rule 2210 was amended to include the participation in an interactive electronic forum in the definition of "public appearance." Hence, the FINRA rules do not require prior approval of postings by member firms or their associated persons on interactive electronic forums, provided that the member firm supervises and reviews such postings in the same manner as required for the supervision and review of correspondence under FINRA Rule 3110(b)(4).

Static communications or postings are regulated as "advertisements" under FINRA rules and, accordingly, are required to have been reviewed by a registered principal. Member firms and their associated persons must be careful to distinguish between static and interactive electronic communications. Under the current FINRA communication rule, any communication by a member firm on social media would be a retail communication, which includes any electronic communication to 25 or more retail investors within any

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<sup>14</sup> *Social Media Websites and the Use of Personal Devices for Business Communications, Guidance on Blogs and Social Networking Websites and Business Communications*, Regulatory Notice 11-39 (August 2011), available at <https://www.finra.org/sites/default/files/NoticeDocument/p124186.pdf>.

<sup>15</sup> *Social Media Web Sites, Guidance on Blogs and Social Networking Web Sites*, Regulatory 10-06 (January 2010), available at <https://www.finra.org/sites/default/files/NoticeDocument/p120779.pdf>.

<sup>16</sup> We note that updated FINRA communications rules became effective in February 2013. See *Communications With the Public, SEC Approves New Rules Governing Communications With the Public*, Regulatory Notice 12-29 (June 2012), available at <http://www.finra.org/sites/default/files/NoticeDocument/p127014.pdf>. In Regulatory Notice 12-29, FINRA indicated that it was codifying its existing guidance.



30-day period. FINRA Rule 2210 no longer retains the “advertisement” and “public appearance” categories, but those terms are useful in explaining FINRA’s disparate treatment of retail communications on the static and nonstatic portions of an interactive electronic forum.

### **Interactive Electronic Forums**

Although a blog (or a bulletin board) may seem to be an online interactive electronic forum, for FINRA, the treatment of a blog will depend on the manner and purpose for which the blog has been constructed. Blogs consisting of static postings are deemed advertisements, and their contents require prior principal approval before posting. Most blogs today are used to engage in real-time interactive communications with third parties. As a result, these blogs may be deemed online interactive electronic forums and regulated as public appearances.

Social networking sites also may be subject to different rules, depending on the nature of the communication. Common social networking sites combine static content and real-time interactive communications (biographical information, status updates and wall uploads versus “comments” and “likes”). Static content remains posted until it is changed by the firm or individual who established the account. Generally, such content is accessible to all visitors of the site or page and is treated by FINRA as an advertisement. On the other hand, interactive content or nonstatic real-time communications have the characteristics of online interactive electronic forums and do not need to be approved by a registered principal, but are subject to the Rule 3310(b)(4) supervision requirements discussed above. Examples of nonstatic, real-time communications include interactive posts, such as “comments” or “likes” on Facebook or “replies” on Twitter, and these are treated as public appearances. They remain subject to the supervision rules.

Although Regulatory Notice 10-06 treats blogs and social networking sites differently, firms should pay close attention to the substance of the communication, not the form. A contemporary blog that is based on real-time interactive communications may still combine static content with interactive content. Firms should consider treating static content on an otherwise interactive blog as advertisements subject to prior approval by a principal.

FINRA recently penalized a registered representative for, among other things, misrepresenting her career accomplishments and her employer firm on a profile posted on a third-party website without obtaining prior principal approval from her then-current employer. FINRA cited FINRA Rule 2110 and Rule 2210. The same representative was cited for violating FINRA Rule 2210 for “tweeting” a recommendation on a particular security

without prior principal approval. According to FINRA, the content of the “tweets” was “unbalanced, overly positive and often predicted an imminent price increase.” FINRA did not object to the form of the communication; it objected to the content and the lack of prior approval.

### **Filing and Recordkeeping**

Almost all communications made by broker-dealers through social media channels will be regarded as “retail communications” under applicable FINRA rules. Broker-dealers should consult FINRA Rule 2210 and establish appropriate policies and procedures designed to ensure compliance with the supervisory review and/or FINRA filing requirements. Retail communications on an online interactive electronic forum are not subject to the filing requirements of Rule 2210. Regulatory Notice 11-39 also addresses recordkeeping. Rules 17a-3 and 17a-4 under the Exchange Act and FINRA Rule 3110 require that a broker-dealer retain electronic communications made by the firm and associated persons that relate to the firm’s business. In Regulatory Notice 11-39, FINRA clarified that the posting of any content on a website by a member firm or its associated persons is a communication under the FINRA rules and, accordingly, is subject to applicable FINRA recordkeeping rules. According to FINRA, the determination of whether an electronic communication relates to a firm’s business “as such,” and hence is subject to the recordkeeping rules, depends on the facts and circumstances and the context and the contents of the communication. Neither the type of device or technology used to transmit the communication nor the ownership of the device is relevant to the determination. Finally, with respect to recordkeeping rules, the requirements are the same for both static and interactive electronic communications.

### **Suitability**

Recommendations to customers regarding the purchase, sale or exchange of any security are regulated under FINRA Rule 2310, more commonly referred to as the suitability rule. Recommendations through a social media website are covered under this rule.

### **Supervision**

FINRA Rule 3010 provides that member firms must establish and maintain a system to supervise the activities of each registered representative, registered principal and other associated person, and that the system must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable FINRA rules. If an associated person wants to use a social media site for

business purposes, FINRA rules require that a registered principal should review the site prior to its use, to the extent that the content is static. A site should be approved for use for business purposes only if the registered principal has determined that the associated person can and will comply with all applicable FINRA communication rules, federal securities laws and individual firm policies.

### **Links to Third-Party Sites**

Regulatory Notice 11-39 also addresses the potential liabilities associated with third-party posts. FINRA explains that a firm may not establish links to third-party sites that the firm knows, or has reason to know, contain false or misleading content, and should not do so when there are red flags to that effect. Further, FINRA advises that under applicable communication rules, a firm may become responsible for content on third-party sites if the firm has adopted or becomes entangled with the content on the third-party sites. A firm may be deemed to be entangled with a third-party site if, for example, the firm participates in the development of content on the third-party site. Also, a firm may be deemed to adopt third-party content if it indicates on its site that it endorses the content on the third-party site. Many social media sites, such as LinkedIn, allow third parties to “recommend” a person and allow users to request recommendations. Member firms should consider prohibiting associated persons from soliciting recommendations. Otherwise, the firm may be deemed to have “adopted” the third-party recommendation.

This guidance is consistent with guidance issued by the SEC with respect to third-party information that is hyperlinked to a public company’s site. Firms should make sure that any links to third-party sites are accessible only through a new window when linking to a site and that a legend appears on the screen warning the reader that he or she is leaving the firm site and disclaiming any responsibility for third-party content. It is unlikely that such legends will shield a member firm from sanction by FINRA, if applicable, but posting such legends may be effective for limiting liability relating to customer claims. Firms should also make sure that their policies relating to social media sites address links to third-party sites.

### **Third-Party Posts, Third-Party Links and Websites**

In addition to adoption and entanglement, if a member firm co-brands a third-party site, it will effectively adopt the content of the entire site. A member firm may co-brand a site by, among other things, placing the firm’s logo prominently on the site.

### **Data Feeds**

FINRA cautions that firms must manage data feeds inputted into their websites. As data feeds may contain inaccurate data, firms must be familiar with the proficiency of the vendor providing the data and its ability to provide accurate data. Managing data feeds involves understanding the criteria used by vendors in collecting or calculating the data, regular review of the data for red flags and promptly taking necessary measures to correct any inaccurate data.

### **Accessing Social Media Sites from Personal Devices**

FINRA explains that firms may permit their associated persons to use personal communication devices to access firm business applications and to perform firm business activity. FINRA cautions, however, that a firm must be able to retain, retrieve and supervise business communications regardless of the ownership of the device used to transmit the communications. According to FINRA, firms should require, if possible, that representatives use separate applications on a device for business communications to facilitate retrieval of the business communications without retrieving personal communications.

FINRA also notes that an application that provides a secure portal into a firm’s communications system is preferable, especially if confidential customer information is shared. If a firm has the ability to separate business and personal communications on a device and has adequate policies and procedures regarding usage, the firm will not be required to (but may voluntarily) supervise personal communications on the device. Firms should consider what devices are most compatible with their internal compliance efforts and require associated persons to limit their business communications to such devices. To facilitate retrieval, it is advisable to ask associated persons to limit personal communications to private email accounts and to prohibit personal communications through firm email accounts.

## **SEC GUIDANCE FOR INVESTMENT COMPANIES**

Investment companies do not necessarily have to file with the SEC interactive content posted in a real-time electronic forum (such as chat rooms or other social media) that is not required to be filed under FINRA Rule 2210.

In guidance published in March 2013, the Staff of the Division of Investment Management described the circumstances when registered investment companies must file interactive content under Section 24 of the

Investment Company Act or Rule 497 under the Securities Exchange Act of 1933, and when it believes filing is not necessary.<sup>17</sup> The Staff takes the basic view that whether a fund must file a particular communication depends on the content, context and presentation of the particular communication. It requires the fund to examine the underlying substantive information transmitted to the social media user and consideration of other relevant facts and circumstances, such as whether the interactive communication is merely a response to a request for information, or whether the fund is sending previously filed content. The guidance contained examples of interactive communications and how the Staff would view a fund's filing requirements.

For example, the Staff said that funds generally would not be required to file the following types of interactive communications:

- Incidental mention of specific funds unrelated to investment merits.
- Incidental use of the word “performance” in connection with discussion of a fund without specific mention of elements of the fund's return.
  - “We update performance of our funds every month and publish them on our website.”
  - “When reviewing a fund's performance, it is important to consider performance against a benchmark.”
- Factual introductory statements including a hyperlink to a prospectus.
- Introductory statements unrelated to a discussion of investment merits of a fund that include a hyperlink and discussions of basic investment concepts or commentaries on economic, political or market conditions.
  - “Our data shows the average 401(k) balance is the highest it's been in more than 10 years! This is partly due to increasing employer and employee contributions.”
  - “The election is over, what is next for our economy? See our report analyzing the elections.”

- Responses to inquiries that provide discrete factual information unrelated to fund performance.

The Staff provided examples of interactive communications that funds should have to file:

- Discussions of fund performance that mention elements of a fund's return or that promote a return.
  - “The fund slightly underperformed its benchmark, the S&P 500 Index, during the quarter that ended March 31, 2013.”
- Communications initiated by users that discuss investment merits of the fund.
  - “Looking for dividends? Think global and consider our new Global Equity Fund [website URL].”

The Staff's guidance provided additional examples; those cited above are representative. In any case, the examples are designed to be nonexclusive.

## CONCLUSION

Given the significance of social media as a preferred method of communication for a growing percentage of market participants, the need to adapt Federal securities laws and the regulatory framework applicable to broker-dealers and investment advisers to social media channels will become all the more urgent. We regularly report on developments in this area through our alerts and blogs, which we hope you will consult.

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<sup>17</sup> Division of Investment Management Guidance No. 2013-01, *Filing Requirements for Certain Electronic Communications* (March 2013), available at <http://www.sec.gov/divisions/investment/guidance/im-guidance-update-filing-requirements-for-certain-electronic-communications.pdf>.

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## Resources

### THE BD/IA REGULATOR

**The BD/IA Regulator** provides frequent, focused, and practical summaries of developments, along with useful analysis and takeaways for broker-dealers, investment advisers, and investment funds.

[www.bdiaregulator.com](http://www.bdiaregulator.com)

### MOFO JUMPSTARTER

Our **MoFo Jumpstarter** blog is intended to provide entrepreneurs, domestic and foreign companies of all shapes and sizes, and financial intermediaries with up-to-the-minute news and commentary on the JOBS Act.

[www.mofojumpstarter.com](http://www.mofojumpstarter.com)

### SociallyAware

In an effort to stay on top of these emerging issues, and to keep our clients and friends informed of new developments, Morrison & Foerster publishes the **Socially Aware** blog, devoted to the law and business of social media.

[www.sociallyawareblog.com](http://www.sociallyawareblog.com)

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