SEC Focuses on Investment Advisers' Use of Social Media

by Jay B. Gould, Ildiko Duckor and Peter J. Chess

On January 4, 2012, the Securities and Exchange Commission (SEC) released a National Examination Risk Alert addressing investment adviser use of social media. Investment advisers should have policies regarding the use of social media, and the SEC outlined specific factors that need to be addressed by these policies. The SEC's guidance could be particularly important given the "crowd-funding" legislation Congress is currently considering.

The January 4, 2012 National Examination Risk Alert (January Alert) states that investment advisers' use of social media must comply with various provisions of the federal securities laws, including the antifraud provisions, the compliance provisions, and the recordkeeping provisions. The January Alert stresses that particular attention with regard to the use of social media must be paid to third party content (if permitted) and the recordkeeping responsibilities.

The January Alert provides staff observations of factors that an investment adviser may want to consider when evaluating a compliance policy for the use of social media. These include, but are not limited to:

- Usage Guidelines. Investment advisers may provide guidance in their policies on the appropriate and inappropriate use of social media;
- Monitoring. Investment advisers may consider how to effectively monitor their social media sites or any use of third-party sites;
- Content Standards. May include clear guidelines and the prohibition of specific content or other content restrictions; and
- Information Security. Investment advisers may consider any information security risks posed by access to social media sites. These could include dangers from hacking and other breaches of information security.

Additionally, investment advisers that allow for third-party posting on their social media sites should consider having policies and procedures in place to address this. Reasonable safeguards should be in place to avoid any violation of the federal securities laws. Potential violations could result from the appearance of testimonials on a firm's social media. For example, the SEC staff believes that the use of social plug-ins such as the "like" button could be considered a testimonial under the Investment Advisers Act of 1940.

Finally, the January Alert notes that investment advisers should consider reviewing their document retention policies so that the retaining of any required records generated by social media use complies with the federal securities laws. This review could include addressing factors such as: determining what types of social media use create a required record; maintaining applicable communications in electronic or paper format; creating training programs to educate advisory personnel about recordkeeping; and, using third parties in order to keep proper records.

The Financial Industry Regulatory Authority (FINRA) has echoed the January Alert in recent releases, such as Regulatory Notice 11-39 from August 2011. This Notice provided guidance on social media websites for broker-dealers, and addressed recordkeeping and third-party sites, among other topics. This Notice supplemented an earlier FINRA notice from January 2010 that provided guidance with regard to blogs and social networking websites.

The SEC has also recently increased its focus on internet-related enforcement actions. On January 4, 2012, the SEC charged an Illinois-based adviser with perpetrating a social media scam. The alleged scam involved offering fictitious securities that were promoted by using LinkedIn. This follows multiple enforcement actions from February 2011 for internet-related schemes, including boiler rooms and spam-email touted pump and dumps.

Crowdfunding

Crowdfunding is a method of capital formation where groups of people pool money, typically by use of very small individual contributions, in order to support the organizers that seek to accomplish a specific goal.

Congress has also been active in the realm of internet-related securities issues with its involvement in crowdfunding. The House of Representative passed the Entrepreneur Access to Capital Act (H.R. 2930) on November 3, 2011. H.R. 2930 provides for registration exemptions for certain crowdfunded securities if the aggregate amount raised through the issuance is $1 million or less each year and each individual who invests in the securities does not invest, in any year, more than the lesser of $10,000 or 10 percent of the investor's annual income. Businesses could raise up to $2 million each year under the exemption if investors were provided with certain financial information.

The Senate currently is considering its own version of a crowdfunding bill, the Democratizing Access to Capital Act of 2011 (S. 1791). S. 1791 provides for registration exemptions for certain crowdfunded securities if the aggregate amount raised through the issuance is $1 million or less each year and each individual who invests in the security does not invest more than $1,000. The Senate Committee on Banking, Housing and Urban Affairs held hearings on December 1 and 14, 2011, regarding this legislation, but a vote on the bill has not yet occurred.

Reaction to the crowdfunding legislation has been mixed. Supporters, such as Tim Johnson, the Chairman of the Senate Committee on Banking, Housing and Urban Affairs, feel that the legislation will provide easier access to capital for smaller businesses and startups, which will grow business

and create new jobs. Detractors, such as Professor John C. Coffee, Jr., in his testimony before the Committee, argue that S. 1791 could well be titled "The Boiler Room Legalization Act of 2011."

The crowdfunding legislation and its developments promise to bring more scrutiny to the interplay of the federal securities laws and the internet. Investment advisers, and other financial firms, should examine and ensure related policies and procedures are up to par.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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