



SOCIAL MEDIA

Social Media

COMPLIANCE GUIDE

for issuers, broker-dealers, and advisers

MAYER • BROWN



The use of social media raises many securities law and compliance challenges for issuers, broker-dealers, and investment advisers. This Compliance Guide summarizes briefly some key principles.

GUIDANCE FOR ISSUERS

REGULATION FD

In 2000, the Securities and Exchange Commission (the “SEC”) adopted Regulation Fair Disclosure (“Regulation FD”) in order to address concerns relating to selective disclosure and to promote full and fair disclosure. In its Regulation FD adopting release, the SEC noted that selective disclosure of information bore a close resemblance to insider trading, giving a privileged few an informational edge and the ability to use that benefit at the expense of others.¹ This unfair advantage, the SEC noted, might lead to a loss of confidence in the integrity of the capital markets. Regulation FD requires that when an issuer, or a person acting on its behalf, discloses material nonpublic information to certain enumerated persons, such as securities market professionals, where it is reasonably foreseeable that they will trade on the basis of the information, the issuer must distribute that information in a manner reasonably designed to achieve effective broad and non-exclusionary distribution to the public. An issuer must make material nonpublic information available to the public contemporaneously if such information is intentionally disclosed or promptly if such material nonpublic information is unintentionally disclosed. These principles are applicable to social media as we discuss below.

DISSEMINATION OF COMPANY INFORMATION

Website Postings

The SEC’s Regulation FD adopting release and Rule 101(e) of Regulation FD state 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.”² In 2008, the SEC issued an interpretive release (the “2008 interpretive release”) on the use of company websites to disseminate information to investors in compliance with Regulation FD.³ The SEC reiterated in its 2008 interpretive release that information is public if it is disseminated “in a manner calculated to reach the securities marketplace in general through recognized channels of distribution, and public investors [are] afforded a reasonable waiting period to react to the information.”⁴ In line with this standard, the SEC set forth the following three factors that a company should evaluate when considering whether its website may be used to disseminate material information for Regulation FD purposes:

¹ *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716 (Aug. 24, 2000), available at: <https://goo.gl/HZhJp6>.

² *Id.*

³ *Commission Guidance on the Use of Company Web Sites*, 73 Fed. Reg. 45,862 (Aug. 7, 2008), available at: <https://goo.gl/VQUc4Y>.

⁴ *Id.*

- whether the company website is a recognized channel of distribution;
- whether posting of information on the company website disseminates the information in a manner making it available to the investors and the markets in general; and
- whether there has been a reasonable waiting period for investors and the markets to react to the posted information.⁵

Recognized Channel of Distribution

Whether a company's website is a recognized channel of distribution depends on a number of factors. To establish a website as a recognized channel for disclosing information, a company should consider:

- promoting its website, by including its website address in its periodic reports and its press releases;
- informing investors and the market in company communications that the company routinely posts important information about the company on its website, including a reference to the URL of the company's website;
- establishing a pattern of posting important information on its website;
- making investor information readily accessible on its website by providing a separate means of accessing the Investor Relations page on the company's website from the company's main website page, ensuring that the website is designed to direct visitors to important information;
- monitoring the dissemination of information in order 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; and
- keeping information current and accurate on the company's website.

Companies with a small market following should consider taking extra steps to improve the accessibility of information on their websites. The SEC noted the use of "push" technology, a type of communication that originates with the publisher of the information, such as RSS feeds or releases through other distribution channels, as additional steps to ensure their websites are a recognized channel of communication.

Dissemination of Information

Whether information is disseminated in a manner that makes the information available to the securities market in general depends on the manner in which information is posted on a company website and the timely and ready accessibility of such information to investors and the markets. The SEC identified in its 2008 interpretive release the following factors that should be considered in determining whether information on a company's website is "posted and accessible" and therefore "disseminated"⁶:

- how the company informs investors and the markets that the company has a website and that such website is where investors and the markets should find company information;
- whether the company has made investors and the markets aware that it will post important information on its website;
- the company's practice of posting such information on its website;
- whether the company's website is designed for clear and easy access to investor information, and the information is presented in a format that is readily accessible to the general public; and

⁵ *Id.*

⁶ *Id.*

- the extent to which information posted on the website is regularly picked up by the market and readily available to and reported by the media.

In public forums, the SEC Staff (the “Staff”) has indicated that an effective model for disseminating information in a Regulation FD-compliant manner, at least with respect to earnings announcements, would be to first furnish an earnings release under cover of a current report on a Form 8-K under Item 2.02 and then to post the earnings release on its website.⁷

Reasonable Waiting Period

A reasonable waiting period for investors to react to website information depends on the circumstances of the dissemination, including the following factors:

- the traffic that the site generates;
- the frequency with which investor-specific information is accessed;
- the steps the company has taken to make investors and the markets aware of the use of the company website as a key source of company information;
- the steps the company has taken to actively disseminate the information or the availability of such information on the company’s website; and
- the complexity of the information presented.

In its 2008 interpretive release, the SEC noted that a reasonable waiting period would vary based on the type of company and the information. For example, a reasonable waiting period for simple information posted on a website with heavy traffic that is routinely used by investors would likely be shorter than the waiting period when complex information is posted on a website that has little traffic and is not routinely used by investors.

Social Media

In April 2013, the SEC issued a Report of Investigation under Section 21(a) (the “21(a) Report”) in the course of an investigation of a potential Regulation FD violation arising from a CEO’s post on Facebook.⁸ The SEC emphasized that disclosure of material nonpublic information to a broader group that includes both enumerated and nonenumerated persons would not render Regulation FD inapplicable. As a result, whenever a company discloses information through a social media channel, the company must consider whether that disclosure implicates Regulation FD. The SEC noted that Regulation FD is not intended to interfere with “legitimate, ordinary course business communications” or communications with the press.⁹ However, an issuer should determine, for example, whether the disclosure includes material nonpublic information and whether the information was disseminated in a manner “reasonably designed to provide broad, nonexclusionary distribution of the information to the public” if the issuer did not file a Form 8-K.

The SEC acknowledged 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 websites, blogs and RSS feeds are used and that the principles articulated in the 2008 interpretative release could be extended to social media channels.

⁷ 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 prompt release of material nonpublic information to the public in a manner that is compliant with Regulation FD.

⁸ *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), available at: <https://goo.gl/LfTZMh>.

⁹ *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716 (Aug. 24, 2000), available at: <https://goo.gl/BzvzU2>.

The SEC noted that an issuer must analyze whether social media channels are recognized channels of distribution. In the 21(a) Report, the SEC noted that personal social media sites of individuals employed by a public company would not ordinarily be assumed by investors to be channels through which a company would disclose material corporate information. The SEC also indicated that, while every situation must be evaluated based on the facts and circumstances, absent advance notice to investors, personal social media sites of public company employees would not be considered Regulation FD compliant, even if such sites have a large number of followers.

To ensure Regulation FD compliance, a company must take steps to alert investors and the markets regarding the channels of communications it intends to use to disseminate material nonpublic information and the types of information that it may disclose through these channels. The steps companies should consider include:

- evaluating which social media channels may be useful to communicate information to investors;
- identifying on its website the social media channels that the company intends to use to disseminate material nonpublic information;
- providing investors and the markets opportunities to subscribe, join or review such channels; and
- alerting investors and the markets of the use of such channels to disseminate material information about the company.

Companies should consider addressing the use of social media in their Regulation FD policies. For example, companies might limit the use of company social media channels to authorized persons. The policy also might address any prohibitions, restrictions or editorial oversight that will govern the use of social media. Company officers, directors and employees should be advised that posting information about the company and its business on company or personal social media channels could potentially implicate Regulation FD. Therefore, such persons must exercise caution when communicating about the company through social media. Companies should monitor the use of all of their social media channels.

LIABILITY AND DISCLAIMERS

Liability for Content on Website or Social Media Platforms

In an interpretive release entitled “Use of Electronic Media” (the “May 2000 Release”), the SEC stated that the federal securities laws apply in the same manner to the content of company websites as to any other statements made by or attributable to the company.¹⁰ An issuer is responsible for the accuracy of statements that “can be reasonably expected to reach investors and the securities markets, regardless of the medium through which the statements are made, including the Internet.”¹¹ Given the potential liability under the securities laws for a material misstatement or omission in public communications, a company should vet any statements by or on behalf of the company made on its website or any social media channels with the same care that it uses in evaluating disclosures in SEC reports. A company also should take care to avoid liability under the “entanglement” theory for third-party information, as we discuss below.

¹⁰ *Use of Electronic Media*, SEC Release No. 33-7856, May 4, 2000, available at: <https://goo.gl/r8PpKt>. The May 2000 Release also includes guidance relating to investment companies.

¹¹ *Id.*

Disclosures by a Person Acting on a Company's Behalf

Regulation FD applies to any communication made by “a person acting on behalf of an issuer.”¹² In the Regulation FD adopting release, the SEC noted such persons include (1) any senior official of the issuer and (2) any other officer, employee, or agent of an issuer who regularly communicates with broker-dealers, investment advisers, investment companies and shareholders. The SEC noted that the definition is intended to cover senior management, investor relations professionals, and others who regularly interact with securities market professionals or security holders.¹³ The obligations under Regulation FD also extend to any employee directed to make a selective disclosure by a member of senior management and such senior management member would be held responsible for the selective disclosure.

Companies should ensure that employees understand the application of Regulation FD. As discussed above, any person communicating company information on social media must consider carefully whether statements made through social media would be attributable to the company and subject to Regulation FD.

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 and has no obligation to correct a misstatement made by a third party. However, a company may be liable for web content provided by a third party that is hyperlinked from the company's website under the “entanglement” theory if the company was involved in the preparation of the information or under the “adoption” theory if the company explicitly or implicitly endorses or approves the information. In addition, companies must be careful about hyperlinking in the forms of “framing” or “inlining” in which a website is imported and displayed along with the website being used. The SEC will generally assume such information was provided by the company as information that would be of interest to its website users and attribute that information to the company.

A company should therefore be careful when referencing and linking to online content that it does not control. The company should also include appropriate legends or disclaimers when referencing or linking third-party content, as discussed below. Activities 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 considered adoption of the analyst's past and future statements about the company or its securities.

Forward-Looking Statements

Sections 27A of the Securities Act of 1933 (the “Securities Act”) and 21E of the Securities Exchange Act of 1934 provide a safe harbor from liability for forward-looking statements (“FLS”), such as estimates, projections, plans and beliefs regarding future performance, if a statement is (1) identified as an FLS and accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from the FLS. Making FLS in certain social media channels that have character limitations, such as Twitter's character limit, may pose challenges. Some companies address this issue by posting multiple disclaimer tweets before tweeting the FLS. Others include links to the FLS disclaimers in their SEC filings or press releases. The SEC Staff has provided guidance in Compliance & Disclosure Interpretations on hyperlinking to certain required disclosures if the particular social media channel has a character limit. However, it remains

¹² See note 1.

¹³ *Id.*

uncertain whether a court would determine that the methods that companies have been using to provide FLS disclaimers on social media channels are sufficient.

Non-GAAP Financial Measures

Regulation G requires issuers to reconcile a non-GAAP financial measure to a comparable GAAP financial measure. This reconciliation requirement also applies to any non-GAAP financial measure provided through social media channels. Companies have satisfied the Regulation G reconciliation requirement by hyperlinking. This approach raises concerns if posts are taken out of context or are partially retweeted. In addition, given the SEC's recent focus on the use of non-GAAP measures,¹⁴ companies are advised to monitor the use of non-GAAP measures in social media communications.¹⁵

USE OF WEBSITES AND SOCIAL MEDIA IN CAPITAL-RAISING TRANSACTIONS

Public Offerings

Gun Jumping

A company conducting a public offering should consider the various SEC rules restricting communications in close proximity to or during an offering. Section 5(c) of the Securities Act prohibits any oral or written offers of a security before a registration statement is filed. Any statements, whether intentional or inadvertent, made prior to filing a registration statement could be deemed to be an offer of securities or an effort to “condition the market” for the offering and may be considered a gun-jumping violation. A gun-jumping violation can put an offering at risk and subject an issuer to a potential SEC enforcement action.

The SEC has indicated that statements made through electronic means, such as media interviews, website postings, emails, Facebook posts and Twitter tweets can be deemed written offers for purposes of the communications rules under the Securities Act. Companies should apply the same level of review applied to communications made through traditional channels to their social media communications. Prior to its first registered public offering, an issuer should consider adopting a social media policy that addresses which social media channels are authorized for use, identifies the persons authorized to communicate on the company's behalf, and sets forth a review process for all such communications. A company also should consider putting in place special controls relating to the content of, and the process for disseminating, information posted on social media channels.

Communications Safe Harbors

Rule 134 Notices

After a prospectus meeting the requirements of Section 10 of the Securities Act (a “Section 10 prospectus”) is filed, Rule 134 permits an issuer conducting a registered public offering to communicate limited factual

¹⁴ See Mary Jo White, Chair, U.S. Securities and Exchange Commission, *Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability* (June 27, 2016), available at: <https://goo.gl/54JfMm>; James V. Schnurr, Chief Accountant, U.S. Securities and Exchange Commission, *Remarks Before the 12th Annual Life Sciences Accounting and Reporting Congress* (Mar. 22, 2016), available at: <https://goo.gl/E8mmzH>; Wesley R. Bricker, Deputy Chief Accountant, U.S. Securities and Exchange Commission, *Remarks Before the 2016 Baruch College Financial Reporting Conference* (May 5, 2016), available at: <https://goo.gl/1YKXnj>; and Mark Kronforst, Chief Accountant, Division of Corporate Finance, U.S. Securities and Exchange Commission, *Remarks at the 36th Annual Ray Garret Jr. Corporate and Securities Law Institute* (Apr. 28, 2016).

¹⁵ See Compliance & Disclosure Interpretations on Non-GAAP Financial Measures, available at: <https://goo.gl/2p8dr8>.

information (a “Rule 134 Notice”) about an offering without such communications being deemed a prospectus or free writing prospectus. If the registration statement is not yet effective, the Rule 134 Notice must contain the name and address of the person or persons from whom a written prospectus for the offering may be obtained and the following legend:

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.

If an issuer provides a 134 Notice pursuant to Rule 134(d) that includes a price range and is accompanied or preceded by a Section 10 prospectus, an issuer may solicit an indication of interest or an offer to buy the security if the 134 Notice contains the following legend:

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.

Securities Act Rules Compliance and Disclosure Interpretations Question 110.01¹⁶ indicates that active hyperlinks are permissible in order to satisfy the legend requirements discussed above if:

- the electronic communication platform has technological limitations such as character or text limitations;
- the inclusion of the entire required legends, 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 legends and prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink.

However, if the electronic communication does not have such limitations, the SEC noted that hyperlinking would not be appropriate.

In addition, the Staff noted 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 or Rule 433 (discussed below) 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.

Rule 433

With the exception of a free writing prospectus under Rule 433(f)(1), any free writing prospectus used pursuant to Rule 433 must contain the following legend:

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

¹⁶ Securities Act Rules Compliance and Disclosure Interpretations (last update Apr. 19, 2017), available at: <https://goo.gl/GzUDwD>.

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. 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, a statement that the documents are also available on the issuer's website and the issuer's website address and the specific location at which the documents are posted.

In the SEC Staff's Securities Act Rules Compliance and Disclosure Interpretation Question 232.15, the Staff noted that it would not object to the use of hyperlinks to fulfill the Rule 433 legend requirement if the conditions listed above (in the context of Rule 134 Notices) are met.

Testing-the-Waters Communications for Emerging Growth Companies

The Jumpstart Our Business Startups Act (the "JOBS Act") amended the securities rules and created a new category of issuer, an emerging growth company ("EGC"). An EGC is defined as an issuer with total gross revenues of less than \$1.07 billion (subject to inflationary adjustment by the SEC every five years) during its most recently completed fiscal year. A company remains an "EGC" until the earliest of:

- the last day of the fiscal year during which the issuer has total annual gross revenues in excess of \$1.07 billion (subject to inflationary indexing);
- 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;
- the date on which such issuer has, during the prior three-year period, issued more than \$1 billion in nonconvertible debt; or
- the date on which the issuer is deemed a "large accelerated filer."

Before or after filing a registration statement, EGCs may "test the waters" ("TTW") and engage in oral or written communications with qualified institutional buyers ("QIBs") and institutional accredited investors ("IAI") (as defined in Rule 501 of the Securities Act) in order to assess interest in a proposed public offering. TTW communications would not constitute "gun jumping" and would not constitute an "offer" for purposes of Section 5 of the Securities Act. It would be difficult to make TTW communications through social media and ensure that such communications are limited to QIBs and IAs.

Private Placements

Prior to 2013, Rule 502(c) of Regulation D prohibited the use 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" for any private offers and sales of securities under Regulation D. The existence of a pre-existing, substantive relationship with an investor negated the concern of general solicitation.

Title II of the JOBS Act, titled “Access to Capital for Job Creators,” required that the SEC adopt rules to relax the prohibition against general solicitation in certain Rule 506 offerings. In 2013, the SEC adopted rules implementing this JOBS Act mandate. As a result, an issuer may conduct an exempt offering using general solicitation under Rule 506(c) of Regulation D as long as (1) the issuer takes reasonable steps to verify the accredited investor status of the purchasers of the securities; (2) all purchasers of securities are 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 (3) the issuer satisfies the conditions of Rule 501 and Rules 502(a) and 502(d). However, the prohibition against general solicitation remains applicable to the extent an issuer relies on the Section 4(a)(2) exemption and/or the Rule 506(b) safe harbor.

Websites and social media channels may play an important role in private placements made pursuant to Regulation D. For example, an issuer conducting a Rule 506(c) offering may use an unrestricted, publicly available website to offer or sell securities.¹⁷ An unrestricted website that does not contain any offering-related information may also be used by a placement agent, a matchmaking portal or another intermediary in order to establish a pre-existing relationship with an investor. However, a website that relies solely on self-certification of accredited investor status, in the absence of any other knowledge of the investor’s financial circumstances or sophistication, is not sufficient to form a “substantive” relationship and will likely not satisfy the Rule 502(c) requirements.¹⁸ Of course, a financial intermediary may have a pre-existing substantive relationship with potential investors and invite such qualified investors to access a password-protected website, and that approach would not involve the use of general solicitation.

With the expanding use of websites and social media channels, companies should take care when employing such communications channels to solicit investors in securities offerings. Certain types of issuers, such as private funds and their registered investment advisers and commodity pools, should take care to understand the additional specific restrictions on the content of their offering-related communications.

Rule 504

In 2016, the SEC also adopted final rules amending Rule 504 (“Rule 504”) of Regulation D in order to (1) increase the aggregate amount of securities that may be offered and sold in any twelve-month period from \$1 million to \$5 million and (2) disqualify certain bad actors from participating in Rule 504 offerings. The final rules repealed Rule 505 of Regulation D, which had provided a safe harbor from registration for securities offered and sold in any twelve-month period from \$1 million to \$5 million.

A Rule 504 offering may be structured as a private placement or as a state-registered offering. If the offering is structured as a private placement, then the issuer cannot use general solicitation or general advertising and must obtain investment representations, impose transfer restrictions, use restrictive legends on the securities, etc. However, if the offering is structured as a state-registered offering, the issuer must comply with state registration requirements (“qualification”) in each state where securities are sold, including preparing and delivering a required “substantive disclosure document before sale” to purchasers in all states (whether or not each state requires registration and delivery of a disclosure document), or sell only to “accredited investors” in accordance with available state law exemptions that permit general solicitation and general advertising.

¹⁷ Securities Act Rules Compliance and Disclosure Interpretations 256.23 (Aug. 5, 2015).

¹⁸ *Citizen VC, Inc.*, SEC No-Action Letter (Aug. 6, 2015) and Securities Act Rules Compliance and Disclosure Interpretation 256.31 (Aug. 5, 2015).

Regulation A

In 2015, the SEC adopted amendments to Regulation A (“Regulation A”), which is an exemption from registration under the Securities Act that allows U.S. and Canadian companies not required to file Exchange Act reports to raise up to \$20 million in a Tier 1 Regulation A offering and up to \$50 million in a Tier 2 Regulation A offering, in each case in a 12-month period. Regulation A also allows sales by existing stockholders under certain conditions.

Under Regulation A, an issuer contemplating a Regulation A offering may conduct TTW communications prior to filing a Form 1-A offering statement with the SEC. An issuer may also use sales literature before or after the filing of the Form 1-A or after qualification of the Form 1-A. After an offering statement is filed, an issuer must provide the filed offering statement or a link to the offering statement when using solicitation materials. All solicitation materials must be filed with the SEC. Most issuers that have relied on the Regulation A offering exemption to date have used internet-based marketing efforts, including targeted social media campaigns, in order to attract interest in the offerings.

Crowdfunding

Title III of the JOBS Act, titled “Crowdfunding,” amends Section 4(a) of the Securities Act to provide a crowdfunding exemption from registration under the Securities Act. An offering under Regulation Crowdfunding (“Regulation CF”) may be a less costly alternative to other current offering exemptions for issuers seeking to raise a limited amount of capital through a broad group of investors over the Internet. Rule 100 of Regulation CF sets forth the following conditions for the exemption:

- the issuer has raised no more than an aggregate amount of \$1,070,000 in the past and the contemplated offerings in reliance on Regulation CF, in a twelve-month period preceding the date of the contemplated crowdfunding transaction;
- individual investors cannot invest more than the following investment amounts in a Regulation CF offering during the twelve-month period preceding the date of the contemplated crowdfunding transaction:
 - the greater of \$2,200 or 5% 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 \$107,000; or
 - 10% of the lesser of the investor’s annual income or net worth, not to exceed a maximum aggregate amount sold of \$107,000, if both the annual income and net worth of the investor is equal to or more than \$107,000;
- the transaction is conducted through an intermediary that is a broker or funding portal that complies with the requirements of the exemption;
- the issuer must be a domestic issuer and not an Exchange Act–reporting company or an investment company; and
- the issuer is not disqualified under the bad actor disqualification provisions under Rule 503 of Regulation CF.

An issuer relying on Regulation CF must provide certain information regarding the issuer and the offering to investors, intermediaries, and file such information with the SEC. In addition, the issuer would need to file with the SEC and post on its website, no less than annually, reports of the results of operations and financial

statements of the issuer as the SEC may determine appropriate. Issuers relying on Regulation CF are also prohibited from advertising the terms of the Regulation CF offering other than providing notices directing investors to the funding portal or broker, offering terms and certain factual information about the issuer. If the issuer compensates any promoter of the offering, the issuer must disclose the amounts paid to the promoter through the intermediary and funding portal. An issuer is subject to 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.

An intermediary that acts as a gatekeeper in crowdfunding must either (1) be a registered broker-dealer and a member of FINRA or (2) if not a registered broker-dealer, must register with the SEC as a funding portal on Form Funding Portal and is prohibited from the following:

- offering investment advice or recommendations;
- soliciting purchases, sales or offers to buy the securities offered or displayed on its platform;
- compensating employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or
- holding, managing, possessing or otherwise handling investor funds or securities.

An intermediary of a crowdfunding portal must ensure that it has conducted certain checks and that the platform meets certain requirements. The following are some of these requirements:

- provide required disclosure, including the risks involved with crowdfunding in general and the contemplated offering to investors;
- have a reasonable basis for believing that an issuer complies with the statutory requirements for a crowdfunding offering and Regulation CF, and that the issuer has established means to keep accurate records of securities holders;
- conduct background checks and securities enforcement regulatory history checks, of officers, directors and significant shareholders of the issuer;
- ensure that issuer information required to be disclosed is available on the platform throughout the offering period and for a minimum of 21 days before any security may be sold in the offering;
- ensure that investors meet the crowdfunding investor limitations;
- provide a communication channel on its platform for investors to communicate with the issuer about the issuer and the offering and have such discussions publicly available for viewing;
- provide disclosures to investors about the compensation the intermediary receives;
- accept an investment commitment from an investor only after that investor certification that they meet Regulation CF requirements, they opened an account and consented to electronic delivery;
- have a reasonable basis for believing an investor complies with the investment limitations in Regulation CF;
- provide investors with certain notices once they have made investment commitments and confirmations at or before completion of a transaction;
- comply with maintenance and transmission of funds requirements;
- ensure that all offering proceeds are provided to the issuers only when the amount equals or exceeds the target offering amount; and
- comply with completion, cancellation and reconfirmation of offerings requirements.

Section 3(a)(11) and Rule 147/Rule 147A Offerings

A number of states permit crowdfunding within their states, or “intrastate crowdfunding.” Under Section 3(a)(11) and Rule 147 of the Securities Act, an issue offered and sold to persons residing in a single state or territory, where the issuer of such security is a person resident or corporation incorporated in and, in each case, doing business within such state or territory, would be exempt from registration under the Securities Act.¹⁹ Rule 147 does not prohibit general advertising or general solicitation in a Section 3(a)(11) offering but such general advertising or general solicitation must be limited to persons resident in the state or territory of which the issuer is conducting the intrastate offering. In Securities Act Rules Questions and Answers of General Applicability Compliance and Disclosure Interpretations Question 141.04, the Staff notes that an issuer relying on 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 adequate measures to ensure that offers of securities are made only to persons resident in the relevant state or territory. These measures must include, among others, the following:

- satisfaction of all conditions under Rule 147;
- disclaimers and restrictive legends that 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.

The Staff also noted in Compliance and Disclosure Interpretations Question 141.05 that issuers may use websites and social media channels to advertise an offering under Rule 147, provided that such offers are limited to persons whose Internet Protocol (“IP”) address originates from the relevant state or territory and prevents any offers to be made to persons whose IP address originates in other states or territories. Offers should include disclaimers and restrictive legends making it clear that the offering is limited to residents of the relevant state under applicable law.

In 2016, the SEC adopted new rules amending Rule 147 and adopting new Rule 147A. Under Rule 147A, issuers are able to conduct exempt intrastate offerings under the same conditions as Rule 147 except Rule 147A offerings can be made to out-of-state residents and the issuer is not required to be a resident or incorporated in such state. However, under both the amended Rule 147 and new Rule 147A, an issuer conducting an intrastate offering must have a principal place of business in the target state or territory and satisfy at least one of the “doing business” qualifications:

- the issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in-state or from the rendering of services in-state;
- the issuer had at least 80% of its consolidated assets located in-state;
- the issuer intends to use and uses at least 80% of the net proceeds from the offering towards the operation of a business or of real property in-state, the purchase of real property located in-state, or the rendering of services in-state; or

¹⁹ See Securities Act Rules Questions and Answers of General Applicability Compliance and Disclosure Interpretations Questions 141.03, 141.04 and 141.05, available at: <https://goo.gl/vsbnHd>.

- a majority of the issuer's employees are based in-state.

Issuers that have changed their principal place of business after making sales in an intrastate offering pursuant to the amended Rule 147 or new Rule 147A, as applicable, cannot conduct another intrastate offering pursuant to either rule in another state for a period of six months from the date of the last sale in the prior state. In addition, an issuer relying on Rule 147 or Rule 147A must obtain written representation from each purchaser as to residency.

SEC GUIDANCE FOR REGISTERED INVESTMENT ADVISERS

ADVISERS ACT AND ADVERTISEMENTS

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 (the “Advisers Act”), which governs advertisements made by investment advisers. This rule (the “Advertisement 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 charge, unless it is actually provided entirely free of charge without condition; or
- contains any untrue statement of a material fact, or that is otherwise false or misleading.

The Staff defines “advertisement” broadly. An “advertisement” includes (1) 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 offers analysis, reports or publications concerning securities, or that is to be used in making any determination as to when to buy or sell any security; (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 the term applies to social media communications, including blogs, photo and video sharing, podcasts, social networking and virtual worlds.

OCIE COMPLIANCE

Use of Social Media

With the increased use of social media by advisers, clients and prospects, the SEC’s Office of Compliance Inspections and Examinations (OCIE) issued a National Examination Risk Alert, dated January 4, 2012 (“2012 Risk Alert”), which provides guidance on the use of social media by registered investment advisers

("RIAs").²⁰ In the 2012 Risk Alert, the Staff noted three areas of concern in the use of social media by RIAs: compliance policies and procedures, third-party content and recordkeeping. On September 14, 2017, OCIE issued a National Examination Risk Alert ("2017 Risk Alert") discussing the most frequent Advertising Rule compliance issues identified in deficiency letters from over 1,000 adviser examinations.²¹

Compliance Policies and Procedures

In the recent Risk Alert, the Staff observed that many firms' compliance policies and procedures for communications do not specifically or appropriately address the use of social media, and such policies and procedures tend to overlap with those applicable to advertisements, investor communications or electronic communications, generally. The lack of specificity for social media use, the Staff noted, may cause confusion as to which procedures or standards are applicable to social media use, and many policies do not specifically address which types of social networking activity are allowed or prohibited. In light of this observation, the Staff provided guidance for RIAs in evaluating their controls and compliance programs, which includes the following:

- **Usage guidelines.** Implement usage guidelines that provide guidance on appropriate and inappropriate use of social media and appropriate restrictions and prohibitions on such use of social media sites based on applicable risks.
- **Content Standards.** Consider the fiduciary duty and other regulatory risks implicated by the social media content created by the RIA and its investment advisory representatives ("IARs"). Consider creating clear guidelines on social media content.
- **Monitoring.** Monitor the RIA's social media sites or its use of third-party sites, taking into account whether the third-party sites provide complete access to a supervisor or compliance personnel.
- **Frequency of Monitoring.** Consider the frequency with which an RIA monitors activity on social media sites, taking into consideration the volume and pace of communications posted on a site or the nature of or probability of misleading content.
- **Approval of content.** Consider preapproval of communications, rather than after-the-fact reviews.
- **Firm resources.** Evaluate whether the RIA has sufficient resources to adequately monitor personnel using social media.
- **Criteria for approving participation.** Establish compliance procedures that assess the risk exposure arising from the use of a social networking site, including a site's reputation, privacy policy, ability to remove third-party posts, controls on anonymous postings and advertising policies.
- **Training.** Consider implementing a training program related to social media, with a view toward promoting compliance and prevention of violations of federal securities laws and an RIA's internal policies.
- **Certification.** Consider certification of compliance with social media policies and procedures.

²⁰ 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://goo.gl/uufZBQ>.

²¹ Office of Compliance Inspections and Examinations, National Examination Risk Alert, Vol. VI, Issue 6, *The Most Frequent Advertising Rule Compliance Issues Identified in OCIE Examinations of Investment Advisers* (Sept. 2017), available at: <https://goo.gl/f5BDTK>.

- **Functionality.** Consider the functionality of an approved social media site, including the continuing obligation to address any upgrades or modifications that affect risk exposure.
- **Personal/professional sites.** Consider adopting policies and procedures to address the RIA or solicitor conducting business on personal or third-party social media sites.
- **Information security.** Evaluate whether allowing access to social media sites poses any information security risks and consider measures for protecting at-risk information.
- **Enterprise-wide sites.** RIAs that are part of a larger financial services or corporate enterprise may consider creating usage guidelines designed to prevent the advertising practices of a firm-wide social media site from violations of the Advisers Act.

Third-Party Content

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 on 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 it broadly construes the type of communication that 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.

Recordkeeping

OCIE noted that the recordkeeping rules do not differentiate between traditional paper communications, like mail, and electronic communications, such as emails, instant messages and other ways that investment advisers provide advisory services. 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 address social media channels.

TESTIMONIALS

In the 2017 Risk Alert, OCIE observed that some advisers’ publication of certain client statements attesting to their services or otherwise endorsing the adviser, such as client endorsements published on firm websites or social media pages, may be prohibited testimonials under subsection (a)(1) of the Advertising Rule. Acknowledging the growing demand by consumers for information through social media, the SEC’s Division of Investment Management set some ground rules on how investment advisers can use social media to publish advertisements that feature public commentary about the advisers and that appears on social media sites.²²

²² The Division of Investment Management Guidance Update No. 2014-4, *Guidance on the Testimonial Rule and Social Media*, available at: <https://goo.gl/dn22cq>.

Generally, advisers may refer to commentary published on social media sites 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.

Section 206 of the Advisers Act 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 SEC 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 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. 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 rule presents compliance challenges for advisers whose clients rely on social media. 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 relied on this concept as the basis for its current guidance.

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

- Advisers may not publish public commentary on their websites 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 designed 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 on the site 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 from the approach adopted by FINRA for broker-dealers. 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.” FINRA focuses on the 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 provides 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, it also provides some compliance challenges, especially when advisers and their representatives make use of social media to advertise.

FORM ADV

The SEC recognizes the growing importance that social media plays in the regulation of investment advisers and believes that having current information on an adviser’s social media presence collected in one place may be helpful to investors and to the SEC. Item 1.I of Part 1A of Form ADV requires registered investment advisers to list the address of each of their accounts on publicly available social media platforms when the adviser controls the content of the platform. Advisers are not required to provide addresses of websites or accounts on social media platforms for which they do not control the content, such as sites that provide job listings or allow the public to rate and review companies. The requirement does not extend to listing the address of an employee’s account on a publicly available social media platform.²³ The SEC stated that “a primary purpose is to provide the Commission and our staff with information that may be used in our examination program and for regulatory purposes.”²⁴ Among other things, the SEC will cross-reference this information with other information to better understand the business and relationships of investment advisers and to improve its regulatory oversight.

INVESTOR ALERT

The SEC also published an Investor Alert, *Social Media and Investing – Avoiding Fraud*,²⁵ intended to make investors aware of fraudulent investment schemes using social media. The alert provides tips for checking the backgrounds of investment advisers and brokers. An Investor Bulletin, *Social Media and Investing*, and *Understanding Your Accounts* provide tips for investors who use social media about privacy settings, security and password selection.

²³ The Division of Investment Management also released a series of frequently asked questions about amended Item 1.I of Form ADV on June 12, 2017, available at: <https://goo.gl/FPm4zr>.

²⁴ Form ADV and Investment Advisers Act Rules, Investment Advisers Act Release No. 4509 at 38 (Aug. 25, 2016), available at: <https://goo.gl/KVtCcd>. Form ADV, highlighted to show changes adopted in 2016, is available at: <https://goo.gl/U4XWJn>.

²⁵ See *Updated Investor Alert: Social Media and Investing – Avoiding Fraud* (Nov. 12, 2014), available at: <https://goo.gl/C3M7YL>.

ROBO-ADVISERS

There has been a fast-growing trend in the investment advisory industry of automated advisers, or “robo-advisers,” that provide more affordable investment advisory services through the internet and innovative technologies. Given that the robo-adviser business model relies largely if not exclusively on internet-based and social media communications, and has attracted significant interest from regulators, we have included in this guide, a brief overview of the current guidance.

In February 2017, the SEC Division of Investment Management (“IM”) issued a Guidance Update (“IM Guidance”) addressing robo-advisers and their compliance with the Advisers Act.²⁶ IM noted that robo-advisers are subject to the substantive and fiduciary obligations of the Advisers Act and because robo-advisers rely on algorithms and provide advisory services over the internet with limited, if any, direct human interaction to their clients, their unique business models may trigger certain issues when seeking to comply with the Advisers Act.”

In the IM Guidance, the Staff focused on three distinct areas:

1. the substance and presentation of disclosures to clients about the robo-adviser and its services;
2. the robo-adviser’s obligation to obtain client information to carry out its duty to provide suitable advice; and
3. the adoption and implementation of effective compliance programs reasonably designed to address particular concerns relating to the provision of automated advice.

IM also noted that robo-advisers should consider whether their organization and operation raise any issues under other federal securities laws, including the Investment Company Act of 1940 (the “Investment Company Act”), in particular Rule 3a-4. Rule 3a-4 is a conditional, non-exclusive safe harbor that provides a basis to defend a discretionary investment advisory program in which all accounts are essentially managed in the same way from being deemed a de facto registered investment company.

Disclosures to Clients

IM noted that the information a client receives from an investment adviser is critical to his or her ability to make informed decisions with respect to the client’s relationship with the investment adviser. An investment adviser has a fiduciary duty to make full and fair disclosure of all material facts to clients and to use reasonable care in avoiding misleading clients. Such information given to clients must be sufficiently specific and be presented in a manner that allows a client to understand the investment adviser’s business practices and conflicts of interests. As there is limited, if any, human interaction between robo-advisers and their clients and given their use of algorithms and the internet, robo-advisers must take care that electronic disclosures made via email, websites, mobile applications and/or other electronic media allow a client to make an informed decision about entering into or continuing an

²⁶ The Division of Investment Management Guidance Update No. 2017-02, Robo-Advisers (February 2017), available at: <https://goo.gl/owQF24>.

investment advisory relationship and that the client understands the limitations, risks and operational aspects of such advisory services.

IM noted the following matters that require close attention for robo-advisers:

Explanation of Business Model

A robo-adviser should disclose, among other information, information regarding its business practices and related risks, including the following:

- use of algorithms and the algorithmic functions used to manage individual client accounts (e.g., that the algorithm generates recommended portfolios, and that individual client accounts are invested and rebalanced by the algorithm);
- an algorithm's assumptions and limitations (e.g., if the algorithm is based on modern portfolio theory, a description of the assumptions underlying, and the limitations of, that theory);
- risks inherent in the use of an algorithm (e.g., that the algorithm might rebalance client accounts without regard to market conditions or on a more frequent basis than the client might expect; and that the algorithm may not address prolonged changes in market conditions);
- circumstances that might cause the robo-adviser to override the algorithm (e.g., that the robo-adviser might halt trading or take other temporary defensive measures in stressed market conditions);
- any involvement by a third party in the development, management or ownership of the algorithm, including an explanation of any conflicts of interest (e.g., if the third party offers the algorithm to the robo-adviser at a discount, but the algorithm directs clients into products from which the third party earns a fee);
- any fees the client will be charged directly by the robo-adviser, and of any other costs that the client may directly or indirectly bear (e.g., fees or expenses clients may pay in connection with the advisory services provided, such as custodian or mutual fund expenses, brokerage and other transaction costs);
- the degree of human involvement in the oversight and management of individual client accounts (e.g., that investment advisory personnel oversee the algorithm but may not monitor each client's account);
- how the robo-adviser uses the information gathered from a client to generate a recommended portfolio and any limitations (e.g., if a questionnaire is used, that the responses to the questionnaire may be the sole basis for the robo-adviser's advice; if the robo-adviser has access to other client information or accounts, whether, and if so, how, that information is used in generating investment advice); and
- how and when a client should update information he or she has provided to the robo-adviser.

Scope of Advisory Services

IM also noted that robo-advisers are subject to the same obligations as all RIAs to ensure that the descriptions of their investment advisory services are clear and that there are no false or misleading

statements relating to the scope of their services. IM noted the following examples of potential false or misleading statements:

- providing a comprehensive financial plan if it is not in fact doing so, such as the robo-adviser not taking into account a client's tax situation or debt obligations, or the robo-adviser providing the investment advice targeted to meet a specific goal without regard to the client's broader financial situation;
- providing comprehensive tax advice when the robo-adviser is only providing tax-loss harvesting service; or
- indication that client information other than that collected by the robo-adviser, its affiliates or third parties and the client is considered when generating investment recommendations if such information is not in fact considered.

Presentation of Disclosures

In the IM Guidance, IM observed that robo-advisers relied on online disclosure to provide important information to clients. The Staff highlighted the importance of the effectiveness of such disclosures in getting important information to clients who may be unlikely to read or understand disclosures that are dense and that are not in plain English. The Staff noted that robo-advisers should consider whether key disclosures necessary for a client to make an informed decision prior to engaging with or making an investment through the robo-adviser (1) are available and presented to potential clients prior to the sign-up process and (2) are emphasized, such as through design features such as pop-up boxes. The Staff also noted that robo-advisers should consider whether some disclosures should be accompanied by interactive text such as tooltips or other means to provide additional details to clients who are seeking more information, and whether disclosures are presented and formatted appropriately to adapt to mobile platforms.

Duty to Provide Suitable Advice

Investment advisers have a fiduciary duty to act in the best interests of their clients and to make reasonable determinations as to whether the investment advice they provide is suitable for a client based on the client's financial situation and investment objectives. IM noted two aspects of the robo-advisers processes that may require attention.

Reliance on Questionnaires for Client Information

IM noted in its IM Guidance that some robo-advisers provide investment advices primarily, if not solely, on client online questionnaires. Based on this limited interaction with the client, IM outlines certain factors robo-advisers should consider when evaluating the sufficiency of their questionnaires for suitability purposes:

- whether the questions elicit sufficient information to allow the robo-adviser to determine that its recommendations and investment advice are suitable and appropriate for a client based on the client's financial situation and investment objectives;

- whether the questions are sufficiently clear and/or designed to provide additional clarification or examples when necessary such as through the use of design features like tooltips or popup boxes; and
- whether steps have been taken to address inconsistent client responses, such as design features that alert a client to internally inconsistent responses or systems that automatically flag apparently inconsistent information for review or follow-up by the robo-adviser.

Client-Directed Investment Strategy Changes

IM observed that many robo-advisers allow clients to select portfolios other than those that have been recommended without giving the client an opportunity to consult with the investment advisory personnel to assess whether such selection is appropriate for the client's investment objectives and risk profile. As this may result in a client choosing unsuitable portfolios, IM noted that robo-advisers should consider providing commentary as to why particular portfolios are more appropriate in light of a client's investment objectives and risk profile and consider implementing design features that alert the client of potential inconsistencies between portfolio selections and the client's investment objectives and risk profile.

Compliance Programs for Automated Advice

All RIAs must implement compliance procedures and policies to ensure that they are in compliance with fiduciary and substantive obligations under the Advisers Act and must evaluate risk exposures related to the nature of the firm's operations. Given the business model of robo-advisers, IM outlined certain factors that robo-advisers should consider in their compliance procedures and policies:

- the development, testing and monitoring of the algorithmic code to ensure that the code is properly integrated into the robo-advisers' platform, performs as represented and any modifications to the code would not adversely affect client accounts;
- the appropriate oversight of any third party that develops, owns or manages the algorithmic code or software modules utilized by the robo-adviser;
- the suitability and appropriateness of client questionnaires used to determine investment recommendations and advice based on a client's financial situation and investment objectives;
- the disclosure to clients of changes to the algorithmic code that may materially affect their portfolios;
- the prevention and detection of, and response to, cybersecurity threats;
- the use of social and other forms of electronic media in connection with the marketing of advisory services; and
- the protection of client accounts and key advisory systems.

SEC GUIDANCE FOR INVESTMENT COMPANIES

The SEC guidance to issuers relating to the application of the federal securities laws in the context of social media, which includes the May 2000 Release, and which we discuss above under “Guidance for Issuers” would apply as well to registered investment companies. In this section, we focus principally on specific guidance provided by the SEC and the Staff relating to social media usage by investment companies. We do not comment on compliance by investment companies with regulatory guidance related to performance advertising matters.

In a March 2013 guidance update (the “2013 Guidance”), the Staff of the Division of Investment Management took the view that whether a registered investment company must file a particular communication under Section 24 of the Investment Company Act or Rule 497 under the Securities Act (if not required to be filed under applicable FINRA rules) depends on the content, context and presentation of the particular communication for relating to interactive content.²⁷ 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. However, funds must examine the underlying substantive information transmitted to the social media user and consider 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 2013 Guidance outlined nonexclusive examples and the Staff’s views on filing requirements applicable to such examples.

Some examples of where no filing would be required are as follows:

- Incidental mention of specific funds unrelated to a discussion of the investment merits of the fund.
 - “Fund X Family of Funds invites you to their annual benefit for XYZ Charity.”
 - “More than 100 Fund X employees volunteered for our Annual Day of Caring!”
- 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 or information filed under Section 24(b) or Rule 497.
 - “The new ABC ETF Strategy Report is now available through this link: [website URL].”
 - “John Doe is the new portfolio manager for ABC fund [website URL].”

²⁷ Division of Investment Management Guidance No. 2013-01, *Filing Requirements for Certain Electronic Communications* (March 2013), available at: <https://goo.gl/j2rE8R>.

- 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 a discussion of the investment merits of the fund.
 - *Inquiry:* “What was the NAV for ABC fund on Friday?”
 - *Fund’s posted response:* “\$xx.xx”
 - *Inquiry:* “What are the fees and expenses for ABC Fund?”
 - *Fund’s posted response:* “Information on the fund’s fees and expenses is available at Feel free to contact us at 1-800-***-**** for more information about this fund.”

Some examples of instances in which filing would be required are as follows:

- Discussions of fund performance that mention some or all of the 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 issuers that discuss investment merits of the fund.
 - “Looking for dividends? Think global and consider our new Global Equity Fund [website URL].”

FINRA GUIDANCE FOR BROKER-DEALERS

On August 18, 2011, FINRA issued Regulatory Notice 11-39,²⁸ providing guidance to broker-dealers on social networking websites and business communications. The notice updated FINRA's guidance contained in Regulatory Notice 10-06 from January 2010.²⁹ 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.³⁰ Most recently, in 2017, FINRA published Regulatory Notice 17-18, which reinforces guidance contained in Regulatory Notices 10-06 and 11-39, and includes additional guidance in the form of questions and answers relating to social media and recordkeeping, third-party posts and hyperlinks to third-party sites.³¹

To understand FINRA's guidance on social media, 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 public appearances.³² 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." As a result, 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 likely be a retail communication, which includes any electronic communication to 25 or more retail investors within any 30-day period. Pursuant to revisions effective in February 2013, 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.

²⁸ *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://goo.gl/zjwHZy>.

²⁹ *Social Media Web Sites, Guidance on Blogs and Social Networking Web Sites*, Regulatory Notice 10-06 (January 2010), available at: <https://goo.gl/efe79M>.

³⁰ 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: <https://goo.gl/yj95b3>. The updates to Rule 2210 (Communications with the Public) codified much of the existing guidance.

³¹ *Social Media and Digital Communications, Guidance on Social Networking Websites and Business Communications*, Regulatory Notice 17-18 (April 2017), available at: <https://goo.gl/1SseL5>.

³² See Regulatory Notice 10-06 at 1 and n.3.

INTERACTIVE ELECTRONIC FORUMS

Social networking sites 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. For example, certain portions of the content, such as biographical information, status updates and wall uploads, may be static, whereas “comments” and “likes” will be real-time interactive content. 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.

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.

FINRA 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 Rules 2110 and 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.

Recordkeeping

Regulatory Notices 11-39 and 17-18 address recordkeeping. 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. 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 as such.” 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. Notice 17-18 applied the recordkeeping requirements to digital communications, including text messaging and chat services, and reminded firms that they must ensure that they can retain any business communications before using those services for business purposes. Finally, with respect to recordkeeping rules, the requirements are the same for both static and interactive electronic

communications. Retail communications on an online interactive electronic forum are not subject to the filing requirements of Rule 2210.

Supervision and Review

Under FINRA Rule 3010, member firms must establish and maintain a system to supervise the activities of each registered representative, registered principal and associated person that is reasonably designed to achieve compliance with the applicable securities laws and regulations and with applicable FINRA rules. As part of this requirement, a registered principal must review any social media site that an associated person intends to use for business communications prior to its use and should approve a site 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.

Suitability

If a member firm or its associated persons recommends a security, including through social media channels, FINRA Rule 2111 would apply to such communications. Whether a social media communication is a “recommendation” depends on the facts and circumstances of such communication. FINRA references Notice to Member 01-23 as guidance for member firms in analyzing whether social media communications fall under the “recommendation” definition. In addition, member firms must take care in assessing suitability under Rule 2111 when using social media channels that include functions that make their content widely available or limit access to one or more individuals. FINRA also recommends as best practice that member firms implement policies and procedures that govern communications that promote specific investment products and require prior approval by a registered principal for all interactive electronic communications that recommend a specific investment product and any link to such recommendation.

Third-Party Posts, Third-Party Links and Websites

FINRA generally does not treat posts by customers or other third parties on member firms’ websites as a firm’s communication with the public subject to Rule 2210. However, under certain circumstances, such third-party posts may be attributed to the member firm if (1) the firm involves itself in the preparation of the content or pays for such content under the “entanglement theory” or (2) the firm explicitly or implicitly endorses or approves the content under the “adoption theory.” A response to a third-party business-related communication posted on a firm’s associated person’s personal social media site would be permissible under FINRA rules as long as such communication does not violate the firm’s internal communications policies. In addition, a firm that deletes or blocks certain third-party content to ensure compliance would not be deemed to have entangled itself or adopted such third-party content. In addition, if a firm co-brands any part of a third-party website, such as placing its logo prominently on such site, the firm would be responsible for the content of the entire site as the firm would be deemed to have adopted the site’s content.

Sharing or linking to third-party websites would not be subject to Rule 2210 as long as the member firm is not deemed to have entangled itself or adopted such website under the two theories described above.

Whether the content of other sites is attributable to the member firm will depend on whether the link is “ongoing” or if the member firm has influence or control over the content of the third-party site. A link is ongoing if it is continuously available to investors who visit the member firm’s site, investors have access to the linked site whether or not it contains favorable material about the member firm and the linked site could be updated or changed by the independent third party, and investors would still be able to use the link at the member firm’s site. If the link is ongoing, content at a linked site will not be deemed to have been adopted by the member firm. However, if the firm has any influence or control over the content of the third-party site, the content of that site will be attributable to the firm through the entanglement theory. If a member firm shares or links to content that in turn links to other content and the member firm has influence or control over that other content, the member would be deemed to have adopted the other content. If a member firm shares or links to content that itself is primarily a vehicle for other links, or where the content available through such links forms the entire basis of the article, content accessed through such links would be attributable to the firm through the adoption theory.

Any language used by the member firm to introduce the link must conform to the content standards of Rule 2210(d). 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 that indicate such linked sites contain false or misleading content. If shared or linked content is considered adopted by the member firm, the member firm must ensure that the adopted content, when read in context with the statements in the originating post, complies with Rule 2210’s standards applicable to firm communications.

Firms should consider taking the following steps to avoid liability of third-party content:

- ensure that links to third-party sites are accessible only through a new window when linking to a site;
- ensure that a legend appears on the screen warning the reader that he or she is leaving the firm site and disclaim 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; and
- ensure that their policies relating to social media sites address links to third-party sites.

Many member firms also monitor third-party posts to mitigate the perception that it is adopting or entangling itself with such third-party communications. FINRA’s Social Networking Task Force outlines the following steps as examples of best practices that member firms have adopted:

- establishing appropriate guidelines on use by customers and other third parties that are permitted to post on firm-sponsored websites;
- establishing screening processes of third-party content based on the expected usage and frequency of third-party posts; and
- disclosing firm policies regarding its responsibility for third-party posts.³³

³³ See Regulatory Notice 10-06 at 8.

Testimonials, Endorsements and Recommendations

Similar to third-party posts on a member firm's social media site, unsolicited third-party opinions or comments posted on a business-related site supervised and retained by a member firm or its registered representative are not communications of the firm or the registered representative for purposes of Rule 2210, nor are such unsolicited opinions or comments considered to be testimonials subject to the requirements of Rule 2210(d)(6). However, if a representative of a member firm "likes" or shares favorable comments posted by third parties on the site, then the comments would be adopted by the firm or representative and would be subject to Rule 2210, including the content, supervision, recordkeeping and testimonial requirements. For example, social media sites, such as LinkedIn, allow third parties to "recommend" a person and allow users to request recommendations. If a firm representative shares such recommendation, the firm may be deemed to have "adopted" such third-party recommendations.

A member firm who wishes to display testimonials in compliance with Rule 2210(d)(6) may disclose them either in the interactive electronic communication itself, in close proximity to the testimonial or through a clearly marked hyperlink using language such as "important testimonial information." Firms registered under the Advisers Act are also subject to prohibitions against fraudulent, manipulative or deceptive acts or the use of any advertisement that refers to a testimonial concerning an investment adviser or any advice, analysis, report or other service rendered by the investment adviser.

Access from Personal Devices

FINRA allows firms to permit their associated persons to use personal communication devices for the firm's business communications.³⁴ However, a firm must be able to retain, retrieve and supervise business communications regardless of the ownership of the device used to transmit the communications. Firms should require, if possible, that associated persons use separate applications on a device for business communications to facilitate retrieval of the business communications and to separate personal communications. To facilitate retrieval of business communications, firms should ask associated persons to limit personal communications to private email accounts and to prohibit personal communications through firm email accounts. In addition, a firm should install an application that provides a secure portal into a firm's communications system, 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 which devices are most compatible with their internal compliance efforts and require associated persons to limit their business communications to such devices.

³⁴ See Regulatory Notice 11-39 at 7.

CONCLUSION

The growing trend of social media as a preferred method of communication for a growing percentage of market participants highlights the need for thoughtful policy and procedural change to ensure compliance with changing securities laws and the regulatory framework applicable to issuers, broker-dealers and investment advisers regarding the use of social media channels.

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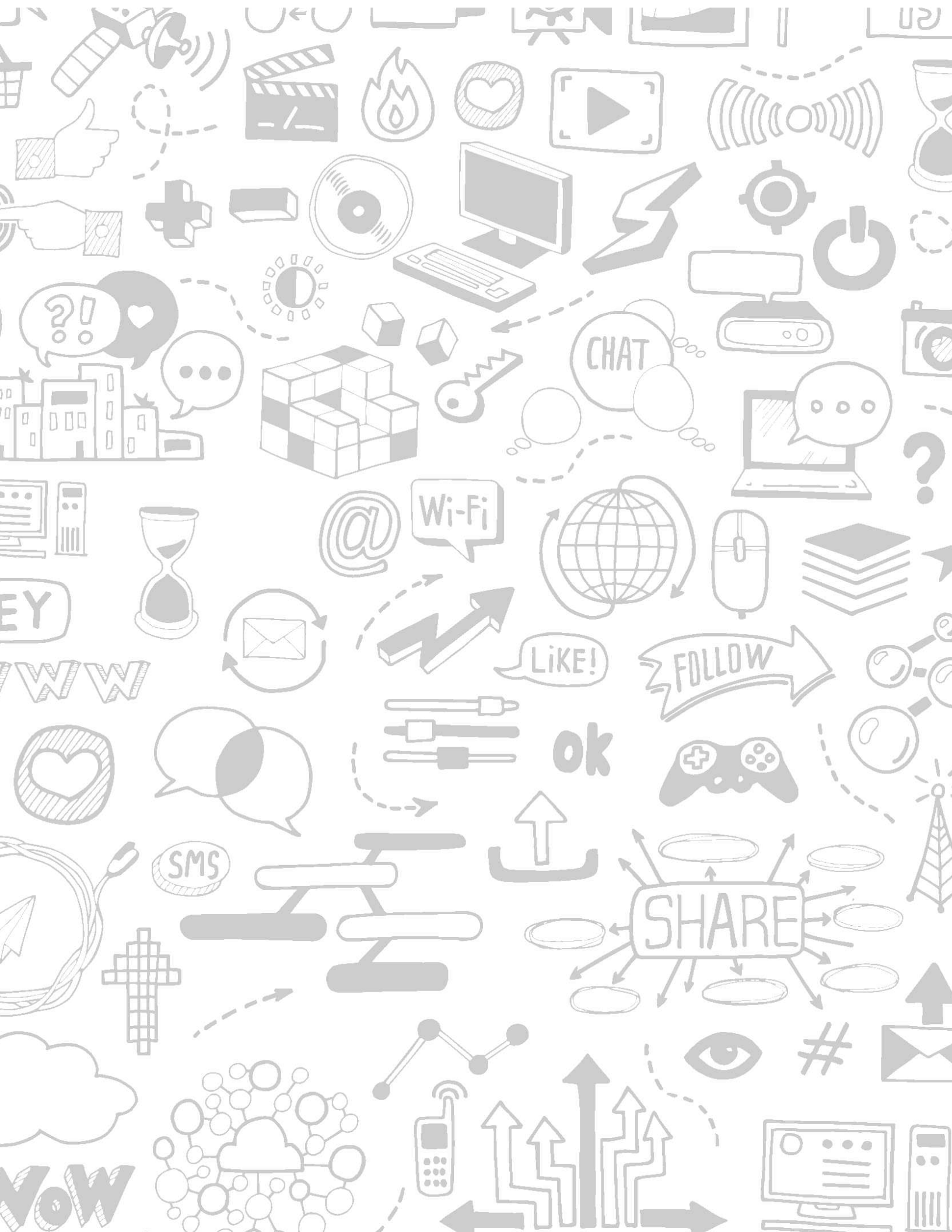
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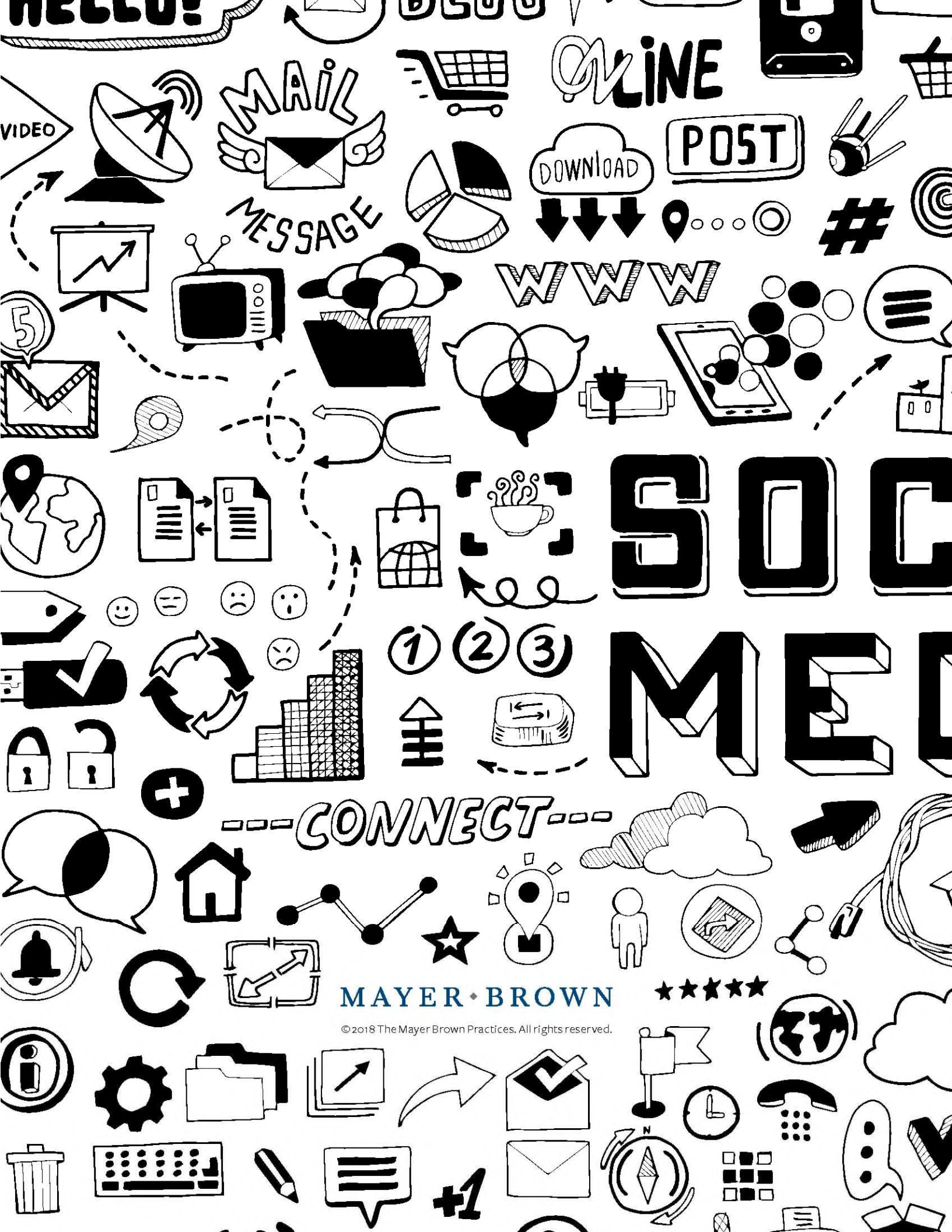
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