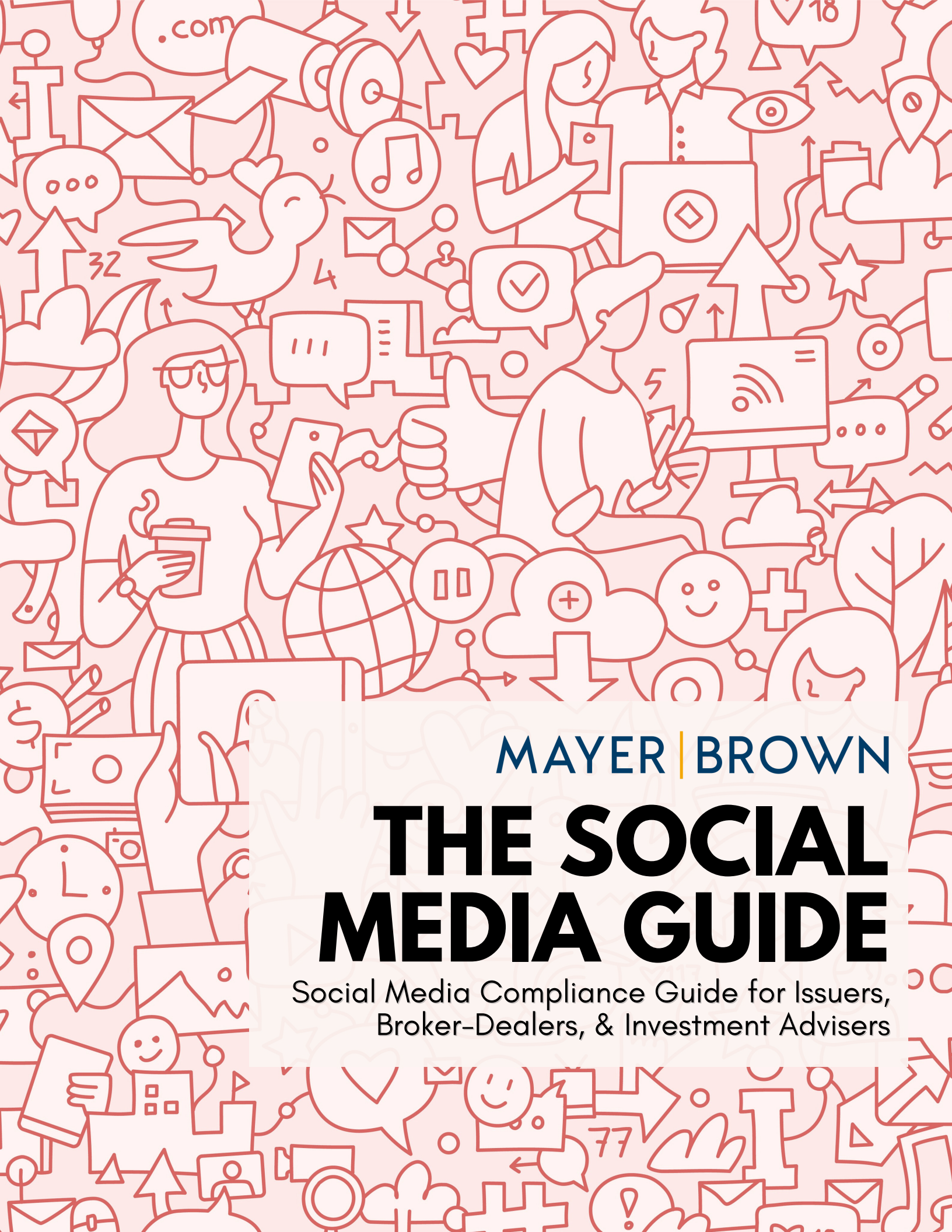

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THE SOCIAL MEDIA GUIDE

Social Media Compliance Guide for Issuers, Broker-Dealers, & Investment Advisers

The use of social media raises 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

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

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:

- 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 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

[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.*
[5] *Id.*

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
- 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;

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[6] *Id.*

[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.

- 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.

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.

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[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.

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.

[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.*

This was relevant when the SEC charged Elon Musk, CEO and former Chairman of Tesla, Inc., with securities fraud and Tesla with failing to have required disclosure controls and procedures relating to Musk's tweets. According to the SEC complaint, Musk's tweets on August 7, 2018 were misleading - they caused Tesla's stock price to jump by over six percent and led to "significant market disruption."[12] Although Tesla notified the market that it would use Musk's Twitter feed to announce material information in 2013, the SEC complaint stated Tesla did not have disclosure controls or procedures to review if Musk's tweets contained information required to be disclosed in SEC filings. According to the complaint, Tesla also did not have sufficient processes to verify that Musk's tweets were accurate and complete. Tesla's settlement with the SEC required Musk to step down as Chairman and prohibited his re-election for three years. The settlement also required Tesla to appoint two new independent directors to its board, establish a new committee of independent directors and put in place additional controls and penalties on Musk's communications. Both Musk and Tesla were charged $20 million penalties to be distributed to harmed investors.[13]

In February 2019, the SEC accused Musk of violating these pre-approval requirements for his tweets. Due to these violations, the SEC asked a Manhattan federal court to consider holding Musk in contempt. Both sides ultimately agreed to clarify the topics that required pre-approval for Musk's tweets. However, despite clarifications, Musk violated the ruling in July 2019 and again in May 2020.[14] The SEC stated in a June 2020 letter to Tesla lawyers that "'[w]e urge the company to reconsider its positions in this matter by acting to implement and enforce disclosure controls and procedures … to prevent further shareholder harm.'"[15]

In addition to vetting statements on social media, a company also should also take care to avoid liability under the "entanglement" theory for third-party information, as we discuss below.

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."[16] 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.[17] The obligations under Regulation FD also extend to any employee directed to make a

[12] *Elon Musk Settles SEC Fraud Charges; Tesla Charged With and Resolves Securities Law Charge, SEC Press release,* September 29, 2018, available at: https://www.sec.gov/news/press-release/2018-226.
[13] *Id.*
[14] Tesla Failed to Oversee Elon Musk's Tweets, SEC Argued in Letters, Wall Street Journal, June 1, 2021.
[15] *Id.*
[16] See note 1.
[17] *Id.*

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 (the "Exchange Act") 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 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 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 focus on the use of non-GAAP measures,[18] companies are advised to monitor the use of non-GAAP measures in social media communications.

Regulation G applies to non-GAAP financial measures in public disclosures, which includes written and oral public disclosures and on the internet. A registrant can adhere to Regulation G requirements when using non-GAAP financial measures in public communications by

1) providing the Regulation G required information on the registrant's website at the time the non-GAAP financial measure is made public; and
2) making public the location of the website in the same presentation in which the non-GAAP financial measure made public.[19]

Foreign Private Issuers ("FPIs") are also subject to Regulation G with limited exceptions.[20]

The Securities Act Rules Compliance and Disclosure Interpretations address areas of concern related to non-GAAP financial measures.[21] They illustrate potentially misleading non-GAAP financial measures that use an individually tailored recognition and measurement method that violates Rule 100(b) of Regulation G.[22] Rule 100(b) states that:

> (b) "A registrant, or a person acting on its behalf, shall not make public a non-GAAP financial measure that, taken together with the information accompanying that measure and any other accompanying discussion of that measure, contains an untrue statement of

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[18] 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).

[19] Note 1 to Regulation G, Rule 100.

[20] Regulation G, Rule 100(c).

[21] See Compliance & Disclosure Interpretations on Non-GAAP Financial Measures, available at: https://goo.gl/2p8dr8.

[22] *Understanding the Requirements Related to the Use of Non-GAAP Financial Measures,* On Point, April 22, 2019, available at: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/04/on-point--understanding-the-requirements-related-to-the-use-of-nongaap.pdf.

a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading."

In comments to an SEC filing, the SEC cited concerns regarding the Investor Relations section of a website in relation to Rule 100(b). The Staff commented that the company posted "earnings slides, supplemental data, and shareholder presentations that include a measure of non-GAAP gross profit calculated as non-GAAP gross profit plus change in deferred revenues, less deferred domain revenues."[23] The Staff stated that this violated Rule 100(b) of Regulation G and to reference Question 100.04 of the Non-GAAP Compliance.[24] Companies should take precautionary measures with their website content to ensure compliance with Regulation G.

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

[23] *Understanding the Requirements Related to the Use of Non-GAAP Financial Measures,* On Point, April 22, 2019, available at: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/04/on-point--understanding-the-requirements-related-to-the-use-of-nongaap.pdf.

[24] *Id.*

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 information (a "Rule 134 Notice") about an offering without such communication 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 110.01[25] indicates that active hyperlinks are permissible in order to satisfy the legend requirement 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.

[25] Securities Act Rules Compliance and Disclosure Interpretations, available at: https://goo.gl/GzUDwD.

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 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 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.

General Solicitation

Securities Act Rules Compliance and Disclosure Interpretation 256.26 notes that "a communication by an issuer or a person acting on the issuer's behalf with a prospective investor with which the issuer or its agent has a pre-existing substantive relationship does not constitute a general solicitation."[26] The SEC guidance states that a relationship is "pre-existing" if it was formed before the start of the issuer's security offering or "established through either a

[26] See Securities Act Rules Compliance and Disclosure Interpretations at Question 256.26.

registered broker-dealer or investment adviser prior to the registered broker-dealer's or investment adviser's participation in the offering."[27]

Many funds conduct continuous offerings, making it difficult to know exactly when an offering begins for all interested investors, so the SEC Staff has established that the timing is determined on a per-investor basis. In Lamp Technologies, Inc., the SEC Staff determined that posting private fund investment information to a password-protected website was not general solicitation, because, in that case, the fund instituted a 30-day waiting period for each investor before the investor could participate in an offering.[28]

Rule 148

Under new Securities Act Rule 148, communications at a seminar or meeting such as a "demo day" will not be deemed to constitute a general solicitation if such communications are made to a specific audience, follow particular restrictions on form of delivery, and follow restrictions on content.[29]

There are specific rules on demo day if it is held virtually. Online participants are limited to:

a) individuals who are members of or otherwise associated with the sponsor organization;
b) individuals who the sponsor reasonably believes are accredited investors; or
c) individuals who were invited to the event by the sponsor based on industry or investment related experience, reasonably selected in good faith, and disclosed in the public communications about the event.[30]

General Advertising

Advertisements aimed to highlight sales of securities or to solicit investors for an offering are considered general advertising.[31] Prohibited advertising includes communications about an offering shared to the general public without limits, instead of to a targeted group of sophisticated investors.[32] The SEC Staff permitted offerors and their agents to distribute generic

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[27] *Id.* At Question 256.26.
[28] See *Lamp Technologies, Inc.,* SEC No-Action Letter (May 29, 1997).
[29] See Rule 148 under the Securities Act, and the discussion in *General Solicitation and General Advertising*, On Point, June 4, 2021, available at: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2021/06/on-point--general-solicitation-june-2021.pdf.
[30] *Id.*
[31] *Gerald F. Gerstenfeld,* SEC No-Action Letter (Dec. 3, 1985) (finding that an advertisement published in *The Wall Street Journal* might constitute general advertising if sent simultaneously with an ongoing or expected offering); *Aspen Grove,* SEC No-Action Letter (Dec. 8, 1982) (finding that the delivery of several brochures with an advertisement in a trade journal is used for the purpose of soliciting investor interests and thus constitutes general advertising).
[32] *Gerald F. Gerstenfeld, supra* note 31; Aspen Grove, *supra* note 31 (finding the advertisement of a limited partnership for thoroughbred horses to be general advertising because of its placement in a trade journal that was "visible, without limitation, to any member of the public").

print and electronic questionnaires to verify investor accreditation before invitation of an investment opportunity. The SEC generally does not find this to be general advertising.[33]

The use of electronic media or the internet to solicit investors is usually considered general advertising unless certain precautionary measures are enacted. The SEC Staff determined that an "offer conducted through an offeror's unrestricted publicly available website would constitute general advertising, even if the website required various forms of information from a prospective investor prior to displaying any offering materials."[34] Websites that publicly and widely invite individuals to qualify as accredited investors may be considered general advertising.[35] The SEC Staff additionally noted that a website that only requires self-certification of accreditation will not be able to benefit from the Rule 506(b) safe harbor for private placements. Instead, an offeror must "additionally implement policies that implement policies that ensure comprehensive review of the accreditation and qualifications of any potential investor prior to any offering through a website or other electronic media outlets."[36]

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;

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[33] *H.B. Shaine & Co.,* SEC No-Action Letter (May 1, 1987) (determining that the distribution of generic questionnaires that collected information about employment history, business experience, business or professional education, investment experience, income, and net worth, did not constitute general advertising); *Bateman Eichler, Hill Richards, Inc.,* SEC No-Action Letter (Dec. 3, 1985) (finding that the mailing of a letter and suitability questionnaire to a limited number of professionals for the purpose of evaluating investor accreditation did not constitute general advertising); Securities Act Release No. 33- 10238 (Oct. 26, 2016).

[34] Securities Act Release No. 3-17512, March 29, 2017; Securities Act Release No. 33-7233, October 6, 1995, reaffirmed in *IPONET*, SEC No-Action Letter, July 26, 1996, [herein, "IPONET"] (finding that a registered broker-dealer did not engage in general advertising when it invited prospective investors to complete a generic questionnaire on its website, without referencing a particular offering or investment opportunity, in order to build a customer base and act as a barrier to sophisticated investment information); Securities Act Rules Compliance and Disclosure Interpretation, supra note 26 at Question 256.23 (". . . the use of an unrestricted, publicly available website constitutes a general advertising and is not consistent with the prohibition on general advertising in Rule 502(c) if the website contains an offer of securities").

[35] *IPONET, supra* note 34; Securities Act Release No. 33-7856 (May 4, 2000).

[36] *Citizen VC, Inc.,* SEC No-Action Letter (August 6, 2015) [herein, "Citizen VC"].

- 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 IAIs.

Under Securities Act Rule 163B, the SEC extended the ability to "test the water" to all issuers, instead of solely EGCs.[37] The rule permits any issuer, or person acting on the issuer's behalf, to engage in TTW communications with investors that are reasonably believed to be IAIs and QIBs. These communications may be oral or written. Issuers may engage in communications prior to or following the date of the filing of a registration statement relating to the offering without violating the SEC's "gun-jumping" rules. The SEC confirmed that issuers could engage in TTW without communications constituting general solicitation, thereby maintaining its ability to pursue a private placement. However, whether a TTW communication would be classified as a general solicitation depends on the facts and circumstances.

Since written communications are included, the SEC amended Securities Act Rule 405 to exclude written communications used in reliance on Rule 163B or Section 5(d) of the Securities Act from the definition of "free writing prospectus." The statements made in any 163B communications must not contain material misstatements or omissions, however, the SEC acknowledged "circumstances or messaging" may change between pre-filing Rule 163B communication and a registration statement filing. Despite similarities to Section 5(d), Rule 163B requires only a reasonable belief that investors receiving communications are QIBs or IAIs. Neither Rule 163B nor the SEC adopting release specifies the steps to establish a reasonable belief of investor status. The intent of this is to provide issuers flexibility to use appropriate cost-effective methods.[38]

[37] See Securities Act Release 33-10699 (September 25, 2019) and *Testing the Waters for All – New Rule 163B Expands TTW to All Issuers*, Mayer Brown Legal Update, September 27, 2019, available at: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/09/legal-update--testing-the-waters2.pdf.

[38] *Id.*

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 Rules 501, 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.

Effective March 15, 2021, and under new Rule 506(c)(2)(ii)(E), an issuer may establish that an investor for whom an issuer has previously taken reasonable steps to verify status as an accredited investor under Rule 506(c)(2)(ii) remains an accredited investor as of the time of a subsequent sale if the investor provides a written representation that it continues to so qualify and the issuer is not aware of any information to the contrary. The SEC also added a five-year time limit for the issuer to rely on the earlier verification.[39] Securities Act Rule 506(b) was also recently modified to limit the number of non-accredited investors that may participate in transactions not involving any public offering as defined in Section 4(a)(2) of the Securities Act to 35 or less within a 90-calendar-day period. It prevents issuers from using the 30-day integration safe harbor to conduct a distribution of securities to 35 different non-accredited investors every month.[40] The safe harbor provides that any offering made more than 30 calendar days before the start of any other offering or 30 calendar days after the completion of any other offering would not be integrated into that offering. However, for an exempt offering for which general solicitation is not permitted that follows by 30 calendar days or more an offering that allows general solicitation, the provisions of Rule 152(a)(1) apply (i.e., the purchasers either were not

[39] See *Exempt Offering Framework Amendments,* Mayer Brown Legal Update, November 3, 2020, available at: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/11/exempt-offering-framework-amendments.pdf.

[40] Securities Act Rules 506(b)(2) and 152; see *id* for a discussion of same.

solicited through the use of general solicitation or established a substantive relationship with the issuer prior to the commencement of the offering for which general solicitation is not permitted).[41]

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.[42] 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.[43] 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 communication 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 2021, Rule 504 ("Rule 504") of Regulation D was amended to increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $5 million to $10 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

[41] See Securities Act Rule 152(b)(1).
[42] Securities Act Rules Compliance and Disclosure Interpretations 256.23 (Aug. 5, 2015).
[43] Citizen VC, and Securities Act Rules Compliance and Disclosure Interpretation 256.31.

accordance with available state law exemptions that permit general solicitation and general advertising.

Regulation A

Regulation A ("Regulation A") is an exemption from registration under the Securities Act that allows U.S. and Canadian companies to raise up to $20 million in a Tier 1 Regulation A offering in a 12-month period. Regulation A was recently modified to raise the threshold in Tier 2 Regulation A offering from $50 million to $75 million in a 12-month period. Regulation A also allows sales by existing stockholders under certain conditions.[44]

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 $5 million in the past and the contemplated offerings in reliance on Regulation CF, in a 12-month period preceding the date of the contemplated crowdfunding transaction;
- accredited investors do not have an investing limit;[45]
- non-accredited 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:

[44] See *Exempt Offering Framework Amendments,* Mayer Brown Legal Update, November 3, 2020, available at: Legal Update – Exempt Offering Framework Amendments.

[45] Rule 100(a)(2) of Regulation CF.

    - 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. In 2020, the SEC adopted amendments that permit oral communications in Regulation CF offerings after Form C is filed and provided that the communications comply with requirements or Rule 204.

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.[46] Rule 147 does not prohibit general advertising or

[46] See Securities Act Rules Compliance and Disclosure Interpretations Questions 141.03, 141.04 and 141.05, available at: https://goo.gl/vsbnHd.

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 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 Securities Act Rules 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 amended Rule 147 and added 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 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
- 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 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

On December 22, 2020, the SEC adopted amendments under the Investment Advisers Act of 1940 (the "Advisers Act") to update rules that govern registered investment adviser marketing and solicitation arrangements. The amendments create a single rule (the "marketing rule"), which replaces the current advertising rule (Rule 206(4)-1), as well as the current cash solicitation rule (Rule 206(4)-3). The SEC also adopted related amendments to Rule 204-2, the books and records rule, and Form ADV, the investment adviser registration form. The marketing rule and amendments to the books and records rule and Form ADV became effective May 4, 2021. The compliance deadline is November 4, 2022. Advisers may begin to comply with the marketing rule any time starting on the effective date but cannot "cherry-pick" between the old rules and the new marketing rule. In other words, until an adviser transitions completely to the amended marketing rule, the adviser must continue to comply with the previous advertising and cash solicitation rules and related Staff's positions.

The amended definition of "advertisement" includes two parts. The first part generally includes the kinds of communications traditionally covered by the advertising rule, with modifications, and the second part generally includes the kinds of activities previously covered by the cash solicitation rule, again with modification. The marketing rule contains seven general prohibitions that apply to all advertisements. The rule also prohibits advertisements that contain testimonials, endorsements, third-party ratings, and performance information, unless certain conditions are met.[47]

The amended definition of advertisement expands the scope of the current rule to encompass all offers of an investment adviser's investment advisory services with regard to securities regardless of how they are disseminated (with limited exception). For example, an adviser might disseminate such communications through emails, text messages, instant messages, electronic presentations, videos, films, podcasts, digital audio or video files, blogs, billboards, and all manner of social media, as well as by paper, including in newspapers, magazines, and the mail. The SEC recognized that electronic media (including social media and other internet communications) and mobile communications play a significant role in current advertising

[47] "Advertisement" is defined in Rule 206(4)-1(e)(1).

practices. The SEC believes that the new definition of advertisement will help the definition remain current in the face of evolving technology and methods of communication.

In the release, the SEC provided guidance specifically regarding social media and more generally regarding the concepts of "entanglement" and "adoption." This applies to the adviser's own website or social media pages, as well as activities of the adviser with respect to third-party websites or social media pages. Under these concepts, third-party information may be attributable to an adviser under the first part of definition of advertisement depending on the facts and circumstances. More specifically, an adviser "adopts" third-party information when it explicitly or implicitly endorses or approves the information. In addition, an adviser could "entangle" itself in a third-party communication if the adviser involves itself in the third party's preparation of the information. As a result of these concepts, in some cases, hyperlinked third-party content could be attributed to the adviser for purposes of the marketing rule. In addition, an adviser's hyperlink to third-party content that the adviser knows or has reason to know contains an untrue statement of material fact or materially misleading information would also be fraudulent or deceptive under Section 206 and other applicable anti-fraud provisions.

Whether content posted by third parties on an adviser's own website or social media page would be attributed to the adviser depends on the facts and circumstances surrounding the adviser's involvement. For example, if an adviser permits all third parties to post public commentary to the adviser's website or social media page, that would not, by itself, render such content attributable to the adviser, so long as the adviser does not selectively delete or alter the comments or their presentation and is not involved in the preparation of the content. This is the case even if the adviser has the ability to influence the commentary but does not exercise it. Thus, if the social media platform allows the adviser to sort the third-party content in such a way that more favorable content appears more prominently, but the adviser does not actually do such sorting, then the ability to sort content would not, by itself, render such content attributable to the adviser.

If an adviser merely permits the use of "like," "share," or "endorse" features on a third-party website or social media platform, the SEC would not interpret the adviser's permission as implicating the marketing rule. However, if the adviser takes affirmative steps to involve itself in the preparation or presentation of the comments, to endorse or approve the comments, or to edit posted comments, those comments would be attributed to the adviser. For example, if an adviser substantively modifies the presentation of comments posted by others by deleting or suppressing negative comments or prioritizing the display of positive comments, then the SEC would attribute the comments to the adviser (i.e., the communication would be an indirect statement of the adviser) because the adviser would have modified third-party comments with the goal of marketing its advisory business.

However, the SEC would not view as adoption an adviser's merely editing profane, unlawful, or other such content according to neutral or objective pre-existing policies or criteria. The criteria must be documented in the adviser's policies and procedures and cannot be designed to favor or disfavor the adviser (e.g., the adviser could not have a policy of removing only negative comments about the adviser), or presumably cannot continuously result in such favoritism.

The SEC also provided guidance regarding the personal social media accounts of an adviser's associated persons. The SEC believes that, under certain circumstances, it could be difficult for an investor to differentiate a communication of the associated person in their personal capacity from a communication the associated person made for the adviser. Whether such a personal communication would be attributed to the adviser depends on a facts and circumstances analysis relating to, among other things, the adviser's supervision and compliance efforts. If the adviser adopts and implements policies and procedures reasonably designed to prevent the use of an associated person's social media accounts to market the adviser's advisory services, the SEC generally would not view such communications as the adviser marketing its advisory services. To achieve effective supervision and compliance, the SEC noted that an adviser may consider also prohibiting such communications, conducting periodic training, obtaining attestations, and periodically reviewing content that is publicly available on associated persons' social media accounts.

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.[48] 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."[49] 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.

[48] 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.

[49] 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.

DIVISION OF EXAMINATIONS RISK ALERT ABOUT ELECTRONIC MESSAGING

In 2018, the SEC's Division of Examinations (then called the Office of Compliance, Inspections and Examinations, or "OCIE") published a risk alert reminding registered investment advisers of their obligations when their personnel use electronic messaging and to help advisers improve their systems, policies, and procedures by sharing the Staff's observations from recent examinations.[50] The risk alert focused on Advisers Act Rule 204-2 ("Books and Records Rule"), which requires advisers to make and keep certain books and records relating to their investment advisory business, including typical accounting and other business records as required by the Commission. The Staff pointed out that the rule requires advisers to make and keep "[o]riginals of all written communications received and copies of all written communications sent by such investment adviser relating to (i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, (iii) the placing or execution of any order to purchase or sell any security, or (iv) the performance or rate of return of any or all managed accounts or securities recommendations," subject to certain limited exceptions. The Staff also noted that the rule requires advisers to keep certain records related to their advertisements. Last, the Staff noted that Advisers Act Rule 206(4)-7 (the "Compliance Rule") requires advisers to, among other things, adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and rules thereunder.

The Staff outlined a number of practices that it believes may assist advisers in meeting their record retention obligations under the Books and Records Rule and their implementation and design of policies and procedures under the Compliance Rule:

Policies and Procedures

• Permitting only those forms of electronic communication for business purposes that the adviser determines can be used in compliance with the books and records requirements of the Advisers Act.

• Specifically prohibiting business use of apps and other technologies that can be readily misused by allowing an employee to send messages or otherwise communicate anonymously, allowing for automatic destruction of messages, or prohibiting third-party viewing or back-up.

• In the event that an employee receives an electronic message using a form of communication prohibited by the firm for business purposes, requiring in-firm procedures that the employee move those messages to another electronic system that the adviser determines can be used in

[50] https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Electronic%20Messaging.pdf.

compliance with its books and records obligations, and including specific instructions to employees on how to do so.

• Where advisers permit the use of personally owned mobile devices for business purposes, adopting and implementing policies and procedures addressing such use with respect to, for example, social media, instant messaging, texting, personal email, personal websites, and information security.

• If advisers permit their personnel to use social media, personal email accounts, or personal websites for business purposes, adopting and implementing policies and procedures for the monitoring, review, and retention of such electronic communications.

• Including a statement in policies and procedures informing employees that violations may result in discipline or dismissal.

Employee Training and Attestations

• Requiring personnel to complete training on the adviser's policies and procedures regarding prohibitions and limitations placed on the use of electronic messaging and electronic apps and the adviser's disciplinary consequences of violating these procedures.

• Obtaining attestations from personnel at the commencement of employment with the adviser and regularly thereafter that employees (i) have completed all of the required training on electronic messaging, (ii) have complied with all such requirements, and (iii) commit to do so in the future.

• Providing regular reminders to employees of what is permitted and prohibited under the adviser's policies and procedures with respect to electronic messaging.

• Soliciting feedback from personnel as to what forms of messaging are requested by clients and service providers in order for the adviser to assess their risks and how those forms of communication may be incorporated into the adviser's policies.

Supervisory Review

• For advisers that permit use of social media, personal email, or personal websites for business purposes, contracting with software vendors to (i) monitor the social media posts, emails, or websites, (ii) archive such business communications to ensure compliance with record retention rules, and (iii) ensure that they have the capability to identify any changes to content and compare postings to a lexicon of key words and phrases.

• Regularly reviewing popular social media sites to identify if employees are using the media in a way not permitted by the adviser's policies. Such policies included prohibitions on using

personal social media for business purposes or using it outside of the vendor services that the adviser uses for monitoring and record retention.

• Running regular Internet searches or setting up automated alerts to notify the adviser when an employee's name or the adviser's name appears on a website to identify potentially unauthorized advisory business being conducted online. Establishing a reporting program or other confidential means by which employees can report concerns about a colleague's electronic messaging, website, or use of social media for business communications. Particularly with respect to social media, colleagues may be "connected" or "friends" with each other and see questionable or impermissible posts before compliance staff notes them during any monitoring.

Control Over Devices

• Requiring employees to obtain prior approval from the adviser's information technology or compliance staff before they are able to access firm email servers or other business applications from personally owned devices. This may help advisers understand each employee's use of mobile devices to engage in advisory activities.

• Loading certain security apps or other software on company-issued or personally owned devices prior to allowing them to be used for business communications. Software is available that enables advisers to (i) "push" mandatory cybersecurity patches to the devices to better protect the devices from hacking or malware, (ii) monitor for prohibited apps, and (iii) "wipe" the device of all locally stored information if the device were lost or stolen.

• Allowing employees to access the adviser's email servers or other business applications only by virtual private networks or other security apps to segregate remote activity to help protect the adviser's servers from hackers or malware.

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 its 2019 interpretive release regarding the standard of conduct for investment advisers, the SEC stated that the interpretative guidance in the release "also applies to automated advisers, which are often colloquially referred to as 'robo-advisers.' Automated advisers, like all SEC-registered investment advisers, are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients."[51]

Robo-advisers also have the attention of the Division of Examinations. In its 2021 examination priorities, the Division of Examinations stated the following:

> Innovations in financial technology and capital formation continue at a rapid pace. This transformation has dramatically changed the way firms interact with their customers and clients. The Division remains committed to staying informed about how these developments impact registrants and investors. Some firms (new and existing) are providing financial services to clients or customers in innovative and evolving ways, such as firms providing advice to clients through automated investment tools and platforms (often referred to as 'robo-advisers') or firms offering automated asset allocation, fractional share purchases, customized portfolios, and mobile applications. Among other areas, examinations will focus on evaluating whether firms are operating consistently with their representations, whether firms are handling customer orders in accordance with customer instructions, and review compliance around trade recommendations made in mobile applications.[52]

This 2021 examination focus was a continuation from the prior year. In its 2020 examination priorities, the Division of Examinations specifically included electronic investment advice as a priority:

> . . . OCIE will continue its focus on RIAs that provide services to their clients through automated investment tools and platforms, often referred to as 'robo-advisers.' Areas of

[51] https://www.sec.gov/rules/interp/2019/ia-5248.pdf.
[52] https://www.sec.gov/files/2021-exam-priorities.pdf.

> focus include, among others: (1) SEC registration eligibility, (2) cybersecurity policies and procedures, (3) marketing practices, (4) adherence to fiduciary duty, including adequacy of disclosures, and (5) effectiveness of compliance programs.[53]

The Division of Examinations' examination priorities for 2018 also included a reference to robo-advisers:

> We will continue to examine investment advisers and broker-dealers that offer investment advice through automated or digital platforms. This includes 'robo-advisers' and other firms that interact primarily with clients online. Examinations will focus on registrants' compliance programs, including the oversight of computer program algorithms that generate recommendations, marketing materials, investor data protection, and disclosure of conflicts of interest.[54]

This 2018 examination focus followed a February 2017 Guidance Update from the SEC Division of Investment Management ("IM" and such guidance, the "IM Guidance") addressing robo-advisers and their compliance with the Advisers Act.[55] 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

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[53] https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf.

[54] https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2018.pdf. The 2017 examination priorities also focused on electronic investment advice: "Investors are increasingly able to obtain investment advice through automated or digital platforms. We will examine registered investment advisers and broker-dealers that offer such services, including 'robo-advisers' that primarily interact with clients online and firms that utilize automation as a component of their services while also offering clients access to financial professionals. Examinations will likely focus on registrants' compliance programs, marketing, formulation of investment recommendations, data protection, and disclosures relating to conflicts of interest. We will also review firms' compliance practices for overseeing algorithms that generate recommendations." https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf.

[55] The Division of Investment Management Guidance Update No. 2017-02, Robo-Advisers (February 2017), available at: https://www.sec.gov/investment/im-guidance-2017-02.pdf.

"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 through email, websites, mobile applications, and/or other electronic media allow a client to make an informed decision about entering into or continuing an 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
- indicating 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 IM 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.[56] 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."

[56] Division of Investment Management Guidance No. 2013-01, *Filing Requirements for Certain Electronic Communications* (March 2013), available at: https://goo.gl/i2rE8R.

- 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]."
- 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 XYZ. 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,[57] 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.[58] 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.[59] 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.[60] Regulatory Notice 19-31 evidences FINRA's full embrace of technological innovations by members communicating with the public.[61]

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.[62] This position was codified in 2003 when NASD Rule 2210, the communications rule, 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).

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[57] *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.

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

[59] 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.

[60] *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.

[61] *Advertising Regulation, Disclosure Innovations in Advertising and Other Communications with the Public*, Regulatory Notice 19-31 (September 19, 2019), available at: Regulatory Notice 19-31 (finra.org).

[62] See Regulatory Notice 10-06 at 1 and n.3.

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.[63] FINRA Rule 2210 no longer retains the "advertisement" and "public appearance" categories, but those terms are useful in explaining FINRA's disparate treatment of retail communications on the static and nonstatic portions of an interactive electronic forum.

INTERACTIVE ELECTRONIC FORUMS

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 depends 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.

[63] See "2210. Communications with the Public" at: https://www.finra.org/rules-guidance/rulebooks/finra-rules/2210.

According to FINRA, the content of the "tweets" were "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.

Similarly, FINRA initiated a disciplinary proceeding against a registered representative who was operating an unapproved website and a social media page to promote his business. FINRA alleged that the content of the communications was not fair and balanced, and also false, exaggerated, unwarranted, promissory or misleading, all in violation of Rule 2210(d). FINRA had no issue with the use of a website or social media page, but a qualified registered principal had not approved the website and social media page prior to the materials being made public, in addition to the content being in violation of Rule 2210(d).[64]

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

Supervision and Review

Under FINRA Rule 3110, 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

[64] FINRA Disciplinary Proceeding No. 2016050212201 (David A. Clark) (default judgment).

has determined that the associated person can and will comply with all applicable FINRA communication rules, federal securities laws and individual firm policies.

Where a member firm failed to maintain a supervisory system that required a weekly review of its registered representatives' social media sites and also did not have a reasonable system to monitor for compliance with its social media policies, the member firm was censured and paid a fine. In that case, among other actions, 38 registered representatives were able to maintain business-related pages on a social media site that had not been approved by a qualified registered principal.[65]

Suitability

If a member firm or its associated persons recommends a security to entities and institutions, or to natural persons who will not use the recommendations primarily for personal, family or household purposes, including through social media channels, FINRA Rule 2111 would apply to such communications.[66] 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 a 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-

[65] FINRA Letter of Acceptance, Waiver and Consent No. 2015047824201 (*Planmember Securities Corporation*).

[66] In 2020, Rule 2111 was amended so that it does not cover most recommendations to retail investors. Recommendations of securities to retail investors by broker-dealers are now governed by Regulation Best Interest (Exchange Act Rule 15l-1).

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.[67]

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." A registered representative who was operating an unauthorized website and social media page, both of which contained non-compliant testimonials, was subject to a FINRA disciplinary proceeding.[68]

Access from Personal Devices

FINRA allows firms to permit their associated persons to use personal communication devices for the firm's business communications.[69] 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

[67] See Regulatory Notice 10-06 at 8.
[68] FINRA Disciplinary Proceeding No. 2016050212201 (David A. Clark) (default judgment).
[69] See Regulatory Notice 11-39 at 7.

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.

Keeping Content Simple

In Regulatory Notice 19-31, FINRA focused on keeping marketing materials fair and balanced, as required by FINRA Rules 2210 – 2220, but also keeping those materials short and sweet. FINRA encouraged member firms to use innovative designs and techniques in their electronic advertising communications, including by means of websites, email, social media, search advertisements, mobile apps and other electronic media.

In the Q&A section of Regulatory Notice 19-31, FINRA stated the following regarding innovative design techniques in member communications:

> FINRA welcomes the use of innovative design techniques in member communications to help investors understand the member's products and services. Members may use technology to customize the level of explanation and information provided in communications. For example, the introductory screen of a mobile app might show a user where to find information on the app. When the user returns to the app, it may offer a choice of whether to view that screen again or access the information on demand. With such an app the user can customize the information according to his or her interests and avoid having to read the same information twice.[70]

But more importantly, FINRA encouraged members to be "precise and succinct in their explanations and disclosures." Members were encouraged to avoid including "rote or prescriptive boilerplate" that is not required by FINRA rules. Although FINRA does not object to additional disclosure, the concern is that it may inhibit or distract from an investor's understanding of the required information.

[70] See Regulatory Notice 19-31 at Q1.

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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The Free Writings & Perspectives, or FW&Ps, blog provides news and views on securities regulation and capital formation. The blog provides up-to-the-minute information regarding securities law developments, particularly those related to capital formation. FW&Ps also offers commentary regarding developments affecting private placements, mezzanine or "late stage" private placements, PIPE transactions, IPOs and the IPO market, new financial products, and any other securities related topics that pique our and our readers' interest. Our blog is available at: www.freewritings.law.

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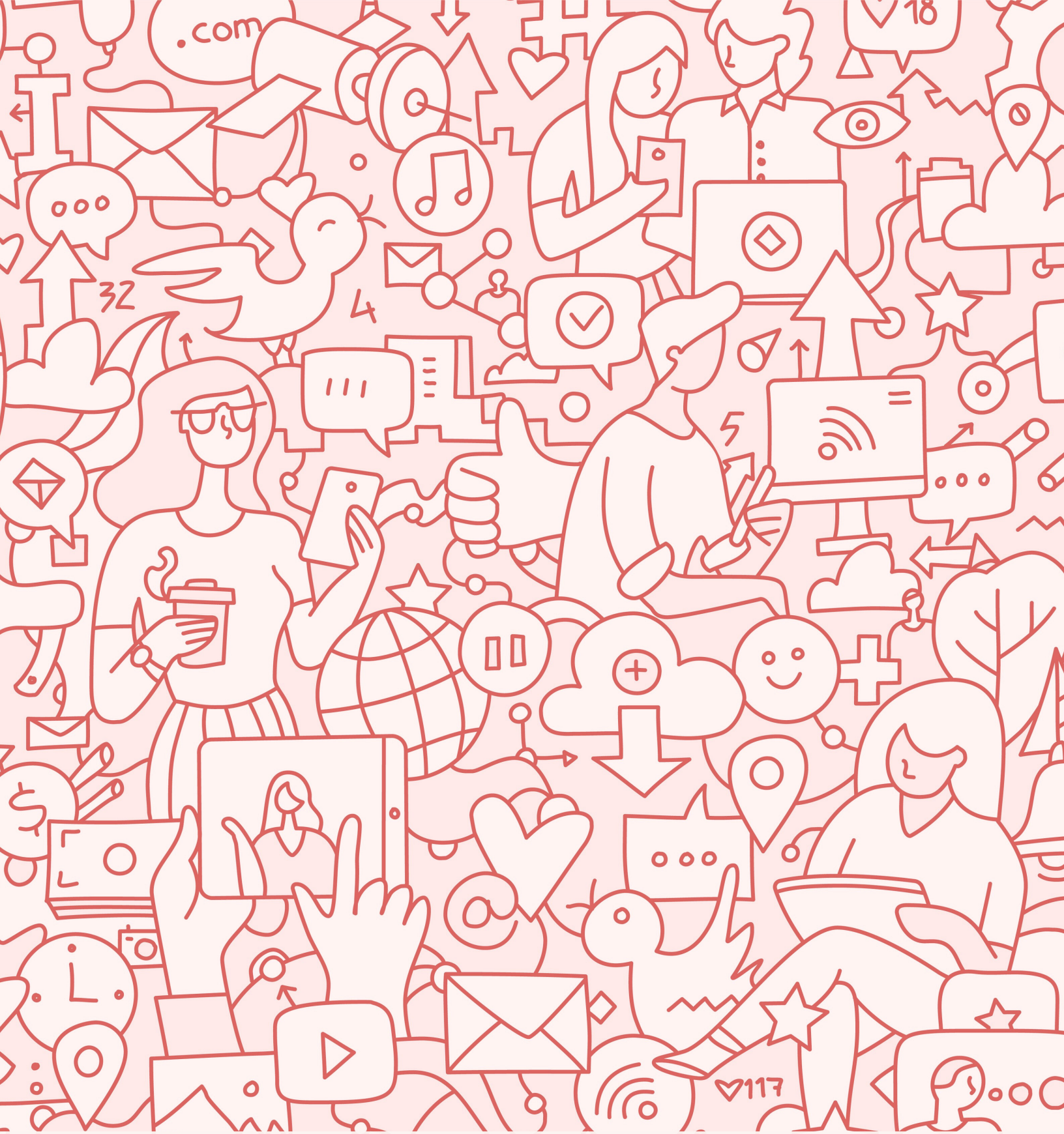

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