Compliance Corner

— By Kerry S. Burke, Covington & Burling LLP, and Brandon K. Gay, The Carlyle Group*

Look Before You Tweet: Advisers and Social Media Considerations

Rapid advancements in social networking and electronic communications technology, which we refer to as social media, have multiplied the channels through which individuals interact with one another. According to a recent study, social networks and blogs reach almost 80% of active U.S. Internet users and account for the majority of Americans' time online.[i] Social media also is an area of increasing regulatory focus. In late 2010, the staff of the Securities and Exchange Commission (the "SEC") conducted a sweep examination of investment advisers' social media practices. Early this year, the SEC charged an Illinois-based adviser in connection with a scheme to sell more than $500 billion in fictitious securities through various social media websites.[ii]

The use of social media presents a number of exciting opportunities for advisers to enhance their client advisory services, along with a host of compliance obligations. In this article, we review the regulatory implications of advisers' social media practices and highlight some practical considerations to keep in mind for assessing social media use.

Regulatory Implications

Although the use of social media by advisers is not specifically addressed in the Investment Advisers Act of 1940, as amended (the "Advisers Act"), it implicates a number of legal requirements, including those discussed below.

Advertising

An "advertisement" under the Advisers Act includes any written communication addressed to more than one person that offers any (1) analysis, report or publication concerning securities, (2) graph, chart, formula or other device for making securities decisions or (3) other investment advisory service with respect to securities. The Advisers Act prohibits advertisements that contain untrue statements of material fact or that otherwise are false or misleading. Due to the broad definition of an advertisement, Facebook or personal blog posts and "tweets" regarding particular securities, investment strategies or performance information likely would be deemed advertisements and subject to the Advisers Act rules on advertising. For instance, many social media websites permit users to endorse the content of others (*e.g.,* "liking" a post on Facebook) or recommend other individuals or service providers (*e.g.,* LinkedIn's recommendation function). In many circumstances, the use of such functions could constitute prohibited testimonials in violation of the advertising restrictions set forth in Rule 206(4)-1 under the Advisers Act.

Anti-Fraud

In addition to the specific advertising rules described above, statements in social media may create liability under other anti-fraud provisions of the Advisers Act and the federal securities laws. For instance, Rule 206(4)-8 under the Advisers Act prohibits a private fund from making material misstatements or omissions to fund investors. This prohibition applies regardless of whether the misstatement or omission is made in an offering memorandum or a "tweet;" however, the casual nature of social media may heighten concerns that an adviser's employees will be less focused on whether their social media interactions potentially violate such anti-fraud provisions. It is unlikely that an employee acting as a representative of an advisory firm can escape anti-fraud liability by indicating that he or she is speaking in an individual capacity instead of on behalf of the firm.

Recordkeeping

Rule 204-2 under the Advisers Act mandates that an adviser maintain extensive books and records. This retention requirement applies irrespective of the medium (*i.e.,* electronic or paper) on which the adviser creates such records. Many practical issues may arise in applying Rule 204-2 to the "records" generated through advisers' use of social media, including the appropriate method of retaining such records (*e.g.,* whether screenshots are sufficient) and whether deleting or otherwise modifying electronic posts would constitute destruction of a record in violation of the required Advisers Act retention periods. Additionally, social media records must be arranged and indexed to promote easy location, access and removal.

Continued on page 21

Other Regulatory Requirements

An adviser's use of social media also could implicate the following regulatory requirements:

- **Privacy.** Regulation S-P governs advisers' use and disclosure of nonpublic personal information about consumers. The ability of social media website users to build an online network of individuals (*e.g.,* Facebook "friends" or LinkedIn "connections") could implicate Regulation S-P if an advisory firm or its employee creates a network based on the individuals extracted from the adviser's list of clients or fund investors.
- **Insider Trading.** Advisory employees may not be as mindful of the risk of conveying material, nonpublic information in their social media posts. Consequently, these casual communications may create increased insider trading risks and pose monitoring challenges for an advisory firm.
- **Private Offering Exemption.** An adviser's posts on Facebook or Twitter regarding a private fund's capital raising activities may constitute a "general solicitation" and accordingly impede a private fund's ability to rely on an exemption under the Securities Act of 1933, as amended, for private placement offerings. This could create serious consequences for the fund, including potential delays, rescission offers and civil and criminal penalties.
- **Other Requirements.** Other legal issues, such as those related to labor and employment and litigation discovery, also may arise from an adviser's use of social media; however, these are beyond the scope of this article.

Regulatory Guidance

In light of the potential legal implications, it is prudent for an adviser to address its and its employees' use of social media. Given the pervasiveness of social media, advisers should at a minimum have policies and procedures outlining the permissible uses of social media. To assist advisers in considering how best to design their policies and procedures, both the SEC staff and the Financial Industry Regulatory Authority, Inc. ("FINRA") recently have issued guidance on social media.

SEC Staff Guidance

Following its sweep examination, in early 2012 the SEC staff published a National Examination Risk Alert on advisers' social media practices.[iii] One issue raised in the Risk Alert was that many advisers have implemented multiple procedures that are relevant to their social media use. If this is the case, an adviser should ensure that its procedures clearly articulate which types of social media activities are permitted and prohibited.

The SEC staff also suggested several factors that advisers should consider in crafting their social media policies. These considerations include:

- whether to establish usage guidelines or content standards, or to require pre-approval of certain social media content;
- compliance monitoring;
- training/certification;
- addressing business and personal use of social media; and
- information security.

These issues are discussed in more detail below.

FINRA Guidance

In crafting policies and procedures, advisers also may consider the regulatory guidance on social media issued to broker-dealers by FINRA.[iv] Among other things, FINRA's guidance on social media highlights the following responsibilities of broker-dealers:

- **Supervision.** A firm's registered principals must review and evaluate an associated person's proposed social media communications for compliance with applicable regulatory requirements. Certain "static" content used for business purposes (such as biographical information about an associated person), as opposed to "interactive" content (*e.g.,* "likes" on Facebook), may require pre-approval.
- **Links to Third-Party Content.** Member firms must not establish a link to any third-party website that they know or have reason to believe contains false or misleading content. In addition, a firm may be deemed responsible for the content of a third-party website if it was involved in the preparation of, or explicitly or implicitly endorsed or approved, the content.
- **Suitability.** Member firms must have reasonable grounds to conclude that securities recommendations, including those made via social media websites, are suitable for their customers.

Practical Considerations

Although policies and procedures must be tailored to an adviser's business, the following are some general measures that an adviser could consider when structuring its social media compliance policies.

To prohibit or not to prohibit? A threshold issue concerns the level and types of social media activity an adviser should permit. Although an absolute ban on all social media is certainly the simplest approach, it may be challenging for a compliance officer to enforce, depending on the level of familiarity and use of social media by the adviser's employees. Often, advisers adopt a more nuanced approach, permitting some social media interactions but not others. For instance, an adviser could consider allowing social media for personal use,

Continued on page 22

continued from page 21

but prohibiting employees from posting certain types of content, such as work-related information. Alternately, some advisers may permit the posting of a limited subset of work-related information, such as an employee's title and firm name on a LinkedIn profile. Advisers should consider prohibiting the dissemination of information that could be construed as a general solicitation, implicate privacy concerns or potentially release proprietary information.

Pre-approval. If an adviser permits its employees to engage in work-related social media activities, it should consider whether certain content should be pre-approved before it is posted. For instance, an adviser could require that its compliance officer approve any information that might be deemed an advertisement before it is publicly disseminated by an advisory employee. In considering whether pre-approval should be granted, an adviser may assess the social media site's functionality, reputation, privacy policy and the ability to remove third party quotes.

Do-over? In crafting social media policies and procedures, an adviser should consider its and its employees' ability to delete or modify a post on a social media website if it is incorrect or creates compliance concerns. For instance, a "tweet" may not be edited once it is posted.[v] A Twitter post may be deleted by the poster; however, the deletion may not be immediately removed from the Twitter search function, and any person receiving the original tweet cannot be prevented from sharing it with others.[vi]

Test effectiveness. As with all policies and procedures, an adviser's compliance group should engage in ongoing monitoring and testing to ensure that all employees comply with social media policies and procedures and that such policies and procedures are effective. The frequency of these oversight activities will be dictated by many factors, including the number of employees, the nature and volume of their social media interactions and the adviser's compliance resources. There are computer software programs that can assist an adviser's compliance group with social media monitoring, although this software may be cost-prohibitive for smaller advisers.

Know your recordkeeping limits. An adviser must ensure that its social media policy is consistent with its recordkeeping capabilities. If a social media post creates a record under the Advisers Act, advisers should take affirmative steps to retain copies of it, for instance, by taking periodic screen shots of employee postings. Additionally, an adviser may consider prohibiting or restricting the use of certain social media activities that create recordkeeping challenges, such as non-static blog posts and information transmitted by employees using an instant messenger function.

Keep current. Social media is dynamic and continually evolving, and advisers should stay abreast of novel technologies and uses. Advisers could consider creating a social media committee composed of tech-savvy employees (or simply confer with the IT department on a regular basis) to monitor developments and suggest changes to the adviser's existing policies and procedures, when appropriate.

Train, baby, train. An adviser should consider training its employees on its social media policies and procedures. Any changes resulting from new developments in technology should be promptly communicated to employees.

Conclusion

In light of the continuing attention focused on the use of social media, advisers must carefully consider how and whether to integrate this technology into their operations. It is likely that social media use will continue to be a reality in advisers' businesses for years to come. Although social media may present unique challenges to advisers, a robust compliance infrastructure tailored to the advisers' actual social media practices is the first line of defense in limiting the liability associated with this use.

**Kerry S. Burke is a partner in Covington & Burling LLP's corporate and securities practice area and Brandon K. Gay is an Associate Vice President and Counsel at The Carlyle Group. Ms. Burke and Mr. Gay are resident in their firms' Washington, D.C. offices and may be reached at kburke@cov.com, or 202-662-5297, and 202-729-5734, or brandon.gay@carlyle.com, respectively.*

Kerry S. Burke, partner, Covington & Burling LLP

Brandon K. Gay, Associate Vice President and Counsel, The Carlyle Group

[i] See State of the Media: The Social Media Report Q3 2011, available at http://www.nielsen.com/content/dam/corporate/us/en/reports-downloads/2011-Reports/nielsen-social-media-report.pdf.

[ii] See SEC Press Release, SEC Charges Illinois-Based Adviser in Social Media Scam (Jan. 4, 2012).

[iii] Investment Adviser Use of Social Media, Office of Compliance Inspections and Examinations National Examination Risk Alert, Volume II, Issue 1 (Jan. 4, 2012).

[iv] See, *e.g.,* FINRA Regulatory Notice 11-39, Social Media Websites and the Use of Personal Devices for Business Communications (Aug. 2011); FINRA Regulatory Notice 10-06, Guidance on Blogs and Social Networking Web Sites (Jan. 2010).

[v] See Can I Edit a Tweet once I've Posted it?, available at http://support.twitter.com/entries/13920-frequently-asked-questions#edit.

[vi] See How to Delete a Tweet, available at http://support.twitter.com/articles/18906-how-to-delete-a-tweet.