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**MAKING MONEY THE MODERN WAY—TWEETING: HOW  
FINRA’S REGULATORY GUIDANCE MAY HELP CLEAR THE WAY  
FOR SOCIAL MEDIA COMMUNICATIONS**

*Jennifer Kimball Vuona\**

*Financial services firms have traditionally been cautious about utilizing emerging communication tools such as social media due to uncertainty regarding the application of existing securities laws to the use of these tools. Recently, regulators have focused their attention on defining the regulations that govern social media. FINRA has taken an active approach to informing financial services firms through podcasts, seminars, notices, priority letters, task forces and press releases about the guidelines for use of social media. This Recent Development argues that FINRA’s guidance on the use of social media by financial institutions is an important step forward in assisting securities lawyers and financial services practitioners with regulatory compliance in a nascent, evolving area of the law. Empowered by FINRA’s new guidance, financial services firms may now start to construct compliance guidelines that incorporate the use of social media. FINRA’s approach strikes a fair balance between allowing companies to take advantage of powerful technologies and protecting investors.*

**I. INTRODUCTION**

In 1979, Smith Barney ran a now-iconic advertising campaign proclaiming, “[we] make money the old fashioned way[,] [we] earn it.”<sup>1</sup> Over thirty years later, the firm’s successor, Morgan Stanley Smith Barney, has announced a plan to allow its financial

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<sup>1</sup> Stuart Elliot, *Smith Barney Summons the Ghost of a Haughty John Houseman in a Revival of its ‘Timeless’ Ads.*, N.Y. TIMES, Aug. 25, 1995, at D5.

advisors to make money the modern way—by “tweeting.”<sup>2</sup> Morgan Stanley is implementing a program that will enable its more than 17,000 financial advisors to communicate with the public through selected social media platforms, including LinkedIn<sup>3</sup> and Twitter.<sup>4</sup> This will mark the first time a major wealth management firm has allowed its financial advisors to utilize Twitter.<sup>5</sup> Morgan Stanley believes that its wealth management division’s first-mover status in adopting this new initiative will provide its advisors with a “significant competitive advantage” in marketing as well as “shar[ing] the firm’s intellectual content” with its clients.<sup>6</sup>

Despite the rapid and widespread adoption of social media platforms by much of the business community,<sup>7</sup> financial professionals have been hesitant to fully enter the social media fray, largely because of regulatory worries.<sup>8</sup> Having received little guidance in the past from the Financial Regulatory Authority

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<sup>2</sup> Twitter is a “real-time information network” which enables users to transmit 140 character messages called “Tweets” to other users. TWITTER, <http://twitter.com/about> (last visited Oct. 17, 2011). “Businesses use Twitter to quickly share information with people interested in their products and services . . . and build relationships with customers.” *Id.*; *Tweet on the Street*, N.Y. TIMES DEALBOOK (May 25, 2011, 2:30 PM), <http://dealbook.nytimes.com/2011/05/25/tweet-on-the-street>.

<sup>3</sup> LinkedIn is a professional networking website with over 120 million users. LINKEDIN, [www.linkedin.com](http://www.linkedin.com) (last visited Oct. 17, 2011).

<sup>4</sup> See Joseph Giannone, *Morgan Stanley OKs Broker use of Social Media*, REUTERS (May 25, 2011, 10:55 AM) <http://www.reuters.com/article/2011/05/25/uk-morganstanley-socialmedia-idUSLNE74O07I20110525>.

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

<sup>6</sup> *Morgan Stanley Smith Barney to Shed Reps’ Social Media Shackles*, INVESTMENT NEWS (May 25, 2011, 12:01 PM), <http://www.investmentnews.com/article/20110525/FREE/110529962>.

<sup>7</sup> See generally HARV. BUS. REV. ANALYTIC SERVS., *THE NEW CONVERSATION: TAKING SOCIAL MEDIA FROM THOUGHT TO ACTION 2* (2010), available at [http://www.sas.com/resources/whitepaper/wp\\_23348.pdf](http://www.sas.com/resources/whitepaper/wp_23348.pdf) (finding that 79% of companies use or plan to use social media).

<sup>8</sup> Clara Shih, *How Advisors Can Be Successful with Social Media*, FA MAGAZINE (Apr. 4, 2011), <http://www.fa-mag.com/online-extras/7144-how-to-be-successful-with-social-media.html> (“Two in three financial professionals say they are reluctant to use social networks due to compliance concerns.”).

(“FINRA”)<sup>9</sup> or the Securities and Exchange Commission (“SEC”)<sup>10</sup> on how new technologies fit within existing securities laws and regulations,<sup>11</sup> financial services firms have been concerned about the potential exposure to violations of securities laws.<sup>12</sup> Potential legal and regulatory risks include violations of rules relating to record keeping,<sup>13</sup> communication with the public,<sup>14</sup> supervisory requirements,<sup>15</sup> suitability,<sup>16</sup> and insider trading.<sup>17</sup> Take for example the extreme case of an individual misusing electronic communication—Raj Rajaratnam, the founder of Galleon Group, who facilitated an insider trading scheme with the use of instant messenger<sup>18</sup> and was sentenced to eleven years in prison.<sup>19</sup>

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<sup>9</sup> FINRA is the largest independent regulator of securities firms. *About the Financial Industry Regulatory Authority*, FINRA, <http://www.finra.org/AboutFINRA/> (last visited Oct. 10, 2011).

<sup>10</sup> “The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.” *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, THE SECURITIES AND EXCHANGE COMMISSION, <http://www.sec.gov/about/whatwedo.shtml> (last visited July 25, 2011) [hereinafter *The Investor's Advocate*].

<sup>11</sup> Jim Pavis, *The Social Media Ball Needs to be Moved Forward*, INVESTMENT NEWS (May 27, 2011, 10:29 AM), <http://www.investmentnews.com/article/20110529/REG/305299969>.

<sup>12</sup> For example, improper use, supervision, or recording of social media could lead to violations of the following: Securities Act rule 17 C.F.R. § 17a-4(b)(4), NASD Rules 2210, 2211, 3010, and 2310, and non-compliance with FINRA Notices 08-77 and 10-06. See generally REEDSMITH, NETWORK INTERFERENCE: A LEGAL GUIDE TO THE COMMERCIAL RISKS AND REWARDS OF THE SOCIAL MEDIA PHENOMENON WHITE PAPER 81–84 (Gregor Pryor et al., eds., 2d ed. 2010), available at [http://www.reedsmith.com/\\_db/\\_documents/2011\\_Social\\_Media\\_White\\_Paper\\_e-Version.pdf](http://www.reedsmith.com/_db/_documents/2011_Social_Media_White_Paper_e-Version.pdf).

<sup>13</sup> 17 C.F.R. § 240.17a-4(b)(4) (2011).

<sup>14</sup> See NASD Rule 2210, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3617](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3617).

<sup>15</sup> See NASD Rule 3010, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3717](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3717).

<sup>16</sup> See NASD Rule 2310, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3638](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638).

<sup>17</sup> See 15 U.S.C. § 78j(b) (2006).

<sup>18</sup> *United States v. Rajaratnam*, No. 09 Cr. 1184 (RJH), 2011 U.S. Dist. LEXIS 91365, at \*21–22 (S.D.N.Y. Aug. 11, 2011) (relying on the following

To clarify uncertainty, regulators have focused attention on this issue over the past two years.<sup>20</sup> Most recently, on August 18, 2011, FINRA released Regulatory Notice 11-39—Guidance on Social Networking Websites and Business Communications.<sup>21</sup> Additionally, in August, FINRA proposed to the SEC a series of changes to the rules governing communication with the public, which determine guidance on social media.<sup>22</sup> This recent FINRA guidance, along with other recent regulatory developments involving social media, is an important step forward in assisting securities lawyers and financial services practitioners with maintaining compliance in a nascent area of the law. While critics might say that regulation could stifle the widespread adoption of emerging technologies, the likely result of the additional clarity and definition in the law is that firms will begin to feel more comfortable adopting the use of social media platforms into their existing communications and marketing practices. This expanded use could impact the way investors choose firms, choose advisors, and most importantly, how they choose their investments.

Part II of this Recent Development will examine the evolving regulatory framework of communications with the public. Part III will discuss the recent regulatory attention on social media by

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exhibits “(5) an instant message from Khan to Rajaratnam telling him ‘Do not buy [Polycom] until I get guidance (GX 64)’; (6) an instant message from Rajaratnam thanking Khan for the information (GX 64); (7) an instant message sent shortly after calls with Khan in which Rajaratnam asked one of his traders to sell all of his Google holdings (GX 1537)”.

<sup>19</sup> Peter Lattman, *Galleon Chief Sentenced to 11-Year Term in Insider Case*, NY TIMES DEALBOOK (Oct. 13, 2011, 11:18 AM), <http://dealbook.nytimes.com/2011/10/13/rajaratnam-is-sentenced-to-11-years/.Peter>.

<sup>20</sup> Richard G. Ketchum, Chairman and Chief Executive Officer, Fin. Indus. Reg. Auth., Remarks at the IRI Government, Legal, and Regulatory Conference, 4 (June 28, 2011), available at <http://www.finra.org/Newsroom/Speeches/Ketchum/P123832>.

<sup>21</sup> *Regulatory Notice 11-39: Guidance on Social Networking Websites and Business Communications*, FIN. INDUSTRY REG. AUTHORITY, 1 (Aug. 2011), <http://www.finra.org/Industry/Regulation/Notices/2011/P124187> [hereinafter *Notice 11-39*].

<sup>22</sup> Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2210, 76 Fed. Reg. 149 (proposed Aug. 3, 2011) (to be codified at FINRA Rule 2214).

state and federal regulators. Parts IV and V will examine guidelines recently issued by FINRA and will consider the implications of those regulations on the securities industry. Parts VI and VII will detail FINRA's proposed rule changes that govern electronic communications with the public, analyze the financial industry's reaction to the proposed rule changes, and explore some of the policy implications.

## II. Background

Proposing federal securities laws in his letter to Congress in 1933, President Franklin D. Roosevelt wrote, "this proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller."<sup>23</sup> In response to Roosevelt's impetus, Congress enacted the Securities Exchange Act of 1934 (the "Exchange Act"),<sup>24</sup> creating the SEC and tasking it with ensuring that investors receive "reliable information and clear rules of honest dealing" from securities professionals.<sup>25</sup> When regulating investment advisors, mutual funds, and broker-dealers, the SEC is primarily concerned "with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud."<sup>26</sup> One area that can be ripe for fraud, misrepresentation, and manipulation is a securities professional's communication with the public.<sup>27</sup> As a result, financial regulators require firms to both supervise and keep records of communication with the public to "guar[d] against investment scams or misleading advice."<sup>28</sup>

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<sup>23</sup> Letter from Franklin D. Roosevelt, President of the U.S., to Congress on Federal Supervision of Investment Securities (March 29, 1933), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=14602#ixzz1Xjnx2umH>.

<sup>24</sup> 15 U.S.C. § 78(a-ii) (2006).

<sup>25</sup> *The Investor's Advocate*, supra note 10.

<sup>26</sup> *Id.*

<sup>27</sup> Giannone, supra note 4. See, e.g., Marcus R. Jones & Hugh H. Makens, *Traps in Electronic Communications*, 8 J. BUS. & SEC. L. 157, 159-60 (2008) (giving an example of securities analyst publicly promoting stock in communications with the public while through private email communications "trashing" the companies).

<sup>28</sup> See Giannone, supra note 4.

### A. *Regulation of Communication*

The SEC is authorized under the Exchange Act<sup>29</sup> to make rules requiring broker dealers to “keep for prescribed periods such records . . . prescribe[d] as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title.”<sup>30</sup> One such rule requires that “originals of all communications received and copies of all communications sent (and any approvals thereof) by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such” are preserved.<sup>31</sup> Those communications must be preserved for at least three years; for the first two years the communications must be stored in an easily accessible place.<sup>32</sup> For illustration, if a financial advisor writes a letter to his or her client base describing a new ETF (exchange-traded fund), the broker-dealer must retain and keep a copy of that letter for at least three years.

Additionally, FINRA rules<sup>33</sup> also regulate various aspects of broker-dealer communications with the public and with clients.<sup>34</sup> NASD Rule 2210 in the FINRA Manual divides communication into six categories: Advertisements, Sales Literature, Correspondence, Institutional Sales Material, Public Appearance

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<sup>29</sup> See 15 U.S.C. § 78(a-ii).

<sup>30</sup> *Id.* § 78(q) (2006).

<sup>31</sup> 17 C.F.R. § 240.17a-4(b)(4) (2011).

<sup>32</sup> *Id.* § 240.17a-4(b)

<sup>33</sup> FINRA was formed by a merger between the enforcement division of the New York Stock Exchange (“NYSE”) and the National Association of Securities Dealers (“NASD”). See Yesenia Cervantes, Article, “*FIN-RAH!*” . . . *A Welcome Change: Why The Merger Was Necessary To Preserve U.S. Market Integrity*, 13 FORDHAM J. CORP. & FIN. L. 829, 830–31 (2008). See generally *FINRA Rules*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/Industry/Regulation/FINRARules/> (last visited Nov. 6, 2011) (explaining that NASD rules are currently included in the “Transitional Rulebook” until the completion of the FINRA “consolidated rulebook.”). See generally 5 THOMAS L. HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 14.3 (6th ed. 2009) (providing detail on the regulation of broker-dealers by self-regulatory agencies).

<sup>34</sup> See NASD Rule 2210, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3617](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3617).

and Independently Prepared Re-prints.<sup>35</sup> Depending on how a communication is categorized the broker-dealer will have different supervisory and record-keeping responsibilities.<sup>36</sup> Additionally, the NASD has general content standards<sup>37</sup> and specific content

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<sup>35</sup> *Id.* at (a)(1). An "Advertisement" is "[a]ny material, other than an independently prepared reprint and institutional sales material, that is published, or used in any electronic or other public media, including any Web site, newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, or telephone directories." *Id.* at (a)(2). "Sales Literature" is:

[a]ny written or electronic communication, other than an advertisement, independently prepared reprint, institutional sales material and correspondence, that is generally distributed or made generally available to customers or the public, including circulars, research reports, performance reports or summaries, form letters, telemarketing scripts, seminar texts, reprints (that are not independently prepared reprints) or excerpts of any other advertisement, sales literature or published article, and press releases concerning a member's products or services.

*Id.* at (a)(3). "Correspondence" is defined in Rule 2211(a)(1). *Id.* at (a)(4). "Institutional Sales Material" is defined in Rule 2211(a)(2). *Id.* at (a)(5). "Public Appearance" is "[p]articipation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity." *Id.* at (a)(6). "Independently Prepared Reprint" is "[a]ny reprint or excerpt of any article issued by a publisher." *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at (d)(1). The general standards are as follows:

(A) All member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading. (B) No member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public. No member may publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading. (C) Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication. (D) Communications with the public may not predict or project performance, imply that past performance will recur or make any



standards<sup>38</sup> for such communication to ensure that communications with the public are based on “fair-dealings and good faith.”<sup>39</sup> Additionally, communications must meet supervisory requirements as outlined in NASD 3010,<sup>40</sup> and suitability requirements under NASD 2310.<sup>41</sup>

With the advent of the use of email and instant messenger in the securities industry, these recordkeeping responsibilities were

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exaggerated or unwarranted claim, opinion or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment or investment strategy. (E) If any testimonial in a communication with the public concerns a technical aspect of investing, the person making the testimonial must have the knowledge and experience to form a valid opinion.

*Id.*

<sup>38</sup> *Id.* at 2210(d)(2). The standards applicable to advertisements and sales literature include:

(A) Advertisements or sales literature providing any testimonial concerning the investment advice or investment performance of a member or its products must prominently disclose the following: (i) The fact that the testimonial may not be representative of the experience of other clients. (ii) The fact that the testimonial is no guarantee of future performance or success. (iii) If more than a nominal sum is paid, the fact that it is a paid testimonial. (B) Any comparison in advertisements or sales literature between investments or services must disclose all material differences between them, including (as applicable) investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features. (C) All advertisements and sales literature must: (i) prominently disclose the name of the member and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction; (ii) reflect any relationship between the member and any non-member or individual who is also named; and (iii) if it includes other names, reflect which products or services are being offered by the member.

*Id.*

<sup>39</sup> *Id.* at (d)(1)(A).

<sup>40</sup> NASD Rule 3010, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3717](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3717).

<sup>41</sup> NASD Rule 2310, available at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3638](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638).

applied to electronic communications.<sup>42</sup> With this application came a “long string of proceedings” by the SEC and FINRA against financial firms for improper recordkeeping of electronic documents.<sup>43</sup> For example, in *SEC v. Morgan Stanley & Co.*,<sup>44</sup> Morgan Stanley agreed to a \$15 million settlement with the SEC for improper storage of electronic communication.<sup>45</sup> Similarly, in *In re Wachovia Capital Markets LLC*,<sup>46</sup> Wachovia agreed to a \$2.2 million fine by the NYSE for failure to preserve electronic records.<sup>47</sup> JP Morgan also agreed to a \$2.1 million fine by the NYSE for failure to preserve electronic communications for a period of three years in violation of 17 C.F.R. § 240.17a-4.<sup>48</sup> More recently, HSBC signed a Letter of Acceptance, Waiver, and Consent (“AWC”) with FINRA on findings that:

From May 2004 until April 2009, HSBC failed to retain certain email sent from company-issued Blackberry devices to email addresses that were not part of HSBC's email system [and] from February 2007 until September 2008, HSBC also failed to retain internal instant messages sent by HSBC associated persons.<sup>49</sup>

Enforcement actions during this period were not just limited to the largest institutions; Leonard & Co, a member firm, signed an AWC with FINRA agreeing to pay a fine of \$65,000 for not properly recording a registered representative's email.<sup>50</sup>

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<sup>42</sup> Jones & Makens, *supra* note 27, at 158 (citing *In re Deutsche Bank*, Exchange Act Release No. 34-45937, 2002 WL 31687142 (Dec. 3, 2002) (stating, “[r]ule 17a-4 is not by its terms limited to physical documents”).

<sup>43</sup> *Id.* at 159.

<sup>44</sup> See *SEC v. Morgan Stanley & Co.*, No. 19693, 2006 SEC LEXIS 1052 (May 20, 2006).

<sup>45</sup> Jones & Makens, *supra* note 27, at 159.

<sup>46</sup> NYSE Exch. Hearing Decision 06-150, 2006 WL 2661052, at \*1 (Aug. 1 2009).

<sup>47</sup> *In re Wachovia Capital Markets LLC*, 2006 WL 2661052, at \*9.

<sup>48</sup> See *In re JP Morgan Securities*, NYSE Exch. Hearing Panel Decision 05-1, 2005 WL 395452, at \*1 (Jan. 5, 2005).

<sup>49</sup> See FINRA *Letter of Acceptance, Waiver & Consent* NO. 2008013863801, to HSBC Sec. (USA) Inc., at 8 (2010).

<sup>50</sup> See FINRA *Letter of Acceptance, Waiver & Consent* NO. 20060064060-02 to *Leonard & Co.*, at 2 (2008).

## B. *Communication Requirements Applied to Social Media*

The number and complexity of electronic communication channels have expanded far beyond email to include a widespread adoption of the use of social media.<sup>51</sup> Securities law practitioners now face the question of how financial services companies can communicate through these new platforms and maintain regulatory compliance.<sup>52</sup> FINRA first addressed this question in March 1999 when it concluded that a “registered representative’s”<sup>53</sup> participation in a chat room is subject to the same regulatory requirements as if he was speaking before a group.<sup>54</sup> Four years later, in 2003, FINRA formally defined “public appearance” to include participation in an “interactive electronic forum” in NASD Rule 2210.<sup>55</sup> As questions and concerns continued to arise with the advent of Facebook, LinkedIn, Twitter, and YouTube, FINRA examined the issue more thoroughly with the creation of the Task Force on Social Networking in 2009.<sup>56</sup> At the same time, FINRA developed its *Guide to the Internet for Registered Representatives* to provide an information resource to help firms develop

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<sup>51</sup> See N. Nayab, *How Technology has Changed Communication*, BRIGHT HUB (July 24, 2010), <http://www.brighthub.com/office/project-management/articles/79052.aspx>.

<sup>52</sup> Richard G. Ketchum, Chairman & Chief Exec. Officer, Fin. Industry Reg. Authority, Address at Securities Industry and Financial Markets Association Annual Meeting (Oct., 27, 2009), available at <http://www.finra.org/Newsroom/Speeches/Ketchum/P120289>.

<sup>53</sup> Registered representatives are:

Persons associated with a member, including assistant officers other than principals, who are engaged in the investment banking or securities business for the member including the functions of supervision, solicitation, or conduct of business in securities or who are engaged in the training of persons associated with a member for any of these functions, are designated as representative.

*FINRA Registration and Examination Requirements*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/industry/compliance/registration/qualificationsexams/registeredreps/p011051> (last visited Oct. 17, 2011).

<sup>54</sup> *Regulatory Notice 10-06: Social Media Websites*, FIN. INDUSTRY REG. AUTHORITY, 1 (Jan. 2010), <http://www.finra.org/industry/regulation/notices/2010/p120760> [hereinafter *Notice 10-06*].

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 2.

compliance guidelines for use of electronic media.<sup>57</sup> FINRA also reached out to the financial services community by conducting seminars on the compliance issues that firms could be facing<sup>58</sup> and releasing podcasts on social media related compliance.<sup>59</sup>

In January 2010, the Social Media Task Force addressed the continuing confusion in the industry by issuing “FINRA Notice 10-06—Social Media Web Sites.”<sup>60</sup> FINRA stated in the Notice that its purpose in providing guidance is to “interpret” existing rules in a “flexible manner” so firms can take advantage of some of these new technologies.<sup>61</sup> This Notice represented a first step toward clarifying many compliance and legal questions.<sup>62</sup> The

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<sup>57</sup> “Static content like a profile, background or wall information is usually considered an “advertisement.” *Guide to the Internet for Registered Representatives*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/industry/issues/advertising/p006118> (last visited October 17, 2011). FINRA further described it as follows:

Static content is generally accessible to all visitors and usually remains posted until it is removed. As with all advertisements and sales literature as defined, a registered principal for the firm must approve all static content. Interactive content includes real-time extemporaneous online discussions with unrelated third parties such as in a chat room. Chat room content is considered a public appearance. Similar to extemporaneous discussions by an RR at a public appearance, interactive content does not require prior principal approval, but must be supervised.

*Id.*

<sup>58</sup> *See id.*; *see also* FINRA Annual Compliance Seminar, *Keep Pace with Regulatory Reform and Compliance Issues*, (May 2011), available at <http://www.finra.org/Industry/Education/ConferencesEvents/AnnualConference/P120873>.

<sup>59</sup> *See Social Media and Personal Electronic Devices*, FIN. INDUSTRY REG. AUTHORITY (Sept. 12, 2011), <http://www.finra.org/Industry/Education/OnlineLearning/Podcasts/>.

<sup>60</sup> *Notice 10-06, supra* note 54, at 1. “The goal of the Notice is to ensure that—as the use of social media sites increases over time—investors are protected from false or misleading claims and representations, and firms are able to effectively and appropriately supervise their associated persons’ participation in these sites.” *Id.* at 2.

<sup>61</sup> *Id.*

<sup>62</sup> Press Release, Fin. Industry Reg. Authority, FINRA Issues Guidance to Firms, Brokers on Communications with Public Through Social Networking

Notice provided some key areas of guidance. NASD Rule 2310, which covers suitability, applies to recommendations for securities made on social media sites.<sup>63</sup> NASD Rule 2210 does not require a registered principal to approve in advance remarks of personnel who participate in an online seminar.<sup>64</sup> FINRA considers social networking sites to contain both static and interactive material; the static portion, not the interactive portion, is categorized as an advertisement, and must be approved in advance by a registered principal<sup>65</sup> subject to NASD Rule 2210.<sup>66</sup> Despite this guidance, Notice 10-06 still left open a great deal of questions within the industry.<sup>67</sup>

### III. RECENT REGULATORY ATTENTION ON SOCIAL MEDIA

2011 brought some key movements by regulators, indicating the degree to which they will focus on the use of social media in the financial services industry. These movements include enforcement action, investigation, and studies on the use of social media by investment advisors, as well as a stated 2011 examination priority by FINRA.

#### A. *FINRA Annual Regulatory and Examination Priorities Letter*

On February 8, 2011, FINRA published its Annual Regulatory and Examination Priorities Letter; this letter outlines areas of “significance” for the FINRA regulatory program, and it also addresses issues that FINRA has stated it may examine across all

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Web Sites (Jan. 25, 2011), available at <http://www.finra.org/Newsroom/NewsReleases/2010/P120780>.

<sup>63</sup> *Notice 10-06*, *supra* note 54, at 3.

<sup>64</sup> *Id.* at 4.

<sup>65</sup> “Registered Principal—Persons associated with a member who are actively engaged in the management of the member's investment banking or securities business, including supervision, solicitation, conduct of business, or the training of persons associated with a member for any of these functions are designated as principals.” *Registered Principal*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/industry/compliance/registration/qualificationsexams/registereds/p011051> (last visited Oct. 17, 2011).

<sup>66</sup> *Notice 10-06*, *supra* note 54, at 6.

<sup>67</sup> *See Notice 11-39*, *supra* note 21, at 1.

institutions or solely with respect to “targeted” institutions.<sup>68</sup> In the 2011 priority letter, FINRA stated that one of its concerns—and hence one of its priorities for examination—is “electronic communications and social media.”<sup>69</sup> FINRA stated that it expects firms to have “adequate systems” in place to retain and supervise all communications, as well as policies relating to permitted activities and any guidelines for those activities.<sup>70</sup> Further, the priority letter reminded firms that any communication relating to the firm’s business is subject to FINRA and SEC communication rules, regardless of the “communication medium or origination point.”<sup>71</sup> This priority letter could prove helpful to the industry, as it will allow firms to get their policies and procedures in place in advance of an examination.

#### B. *Massachusetts Report on Registered Investment Advisor Use of Social Media*

In July 2011, the Securities Division of the Massachusetts Secretary of State issued a report on the use of social media by registered investment advisors in Massachusetts.<sup>72</sup> This report was based on a survey given to 576 investment advisors registered with the Massachusetts state regulator regarding their use of social media.<sup>73</sup> The survey was conducted to help the state regulator determine the scope of social media use, as well as what, “if any,” policies firms had in place for record keeping and supervision of such communication.<sup>74</sup> The survey showed that a growing number

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<sup>68</sup> See *Annual Regulation and Priority Letter*, FIN. INDUSTRY REG. AUTHORITY, 1 (Feb. 8, 2011), <http://www.finra.org/Industry/Regulation/Guidance/P122861> (follow “2011 Regulatory and Examination Priorities Letter” hyperlink).

<sup>69</sup> *Id.* at 9.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> See WILLIAM FRANCIS GALVIN, SEC’Y OF THE COMMONWEALTH OF MASS., REPORT ON MASSACHUSETTS INVESTMENT ADVISORS USE OF SOCIAL MEDIA 1 (2011), available at <http://www.sec.state.ma.us/sct/sctmediasurvey/socialmedia.pdf>.

<sup>73</sup> *Id.* at 1.

<sup>74</sup> *Id.*

of investment advisors in Massachusetts are using social media; in fact, over forty-four percent of firms surveyed are currently using some type of social media.<sup>75</sup> Of the firms utilizing such forms of communication, many do not have policies in place to supervise and record these communications; for example, sixty-nine percent of the firms surveyed did not have written retention policies in place for social media content.<sup>76</sup> The Massachusetts State Securities Division concluded that firms may need more guidance from it on the use of social media.<sup>77</sup> In order to determine the best course of action for regulation, the Division created a working group that will examine how firms may best utilize emerging technologies while keeping regulatory obligations in mind.<sup>78</sup>

This development may be a sign to investment advisors across the country that state regulators may begin looking at this issue a bit more closely.<sup>79</sup> In fact, Massachusetts state regulatory actions could be the “canary in the coal mine for future social media regulation.”<sup>80</sup> Also, under section 410 of the recently enacted Dodd-Frank Act,<sup>81</sup> investment advisors with assets under \$100,000,000 will now register with the state securities regulator instead of the SEC.<sup>82</sup> As a result of this change under the Dodd-Frank Act, the social media programs of the 3200 investment

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<sup>75</sup> *Id.*

<sup>76</sup> *Id.* at 3.

<sup>77</sup> *Id.* at 1.

<sup>78</sup> *Id.* at 3.

<sup>79</sup> Scott Peterson, *Massachusetts Securities Division Leads States Towards Social Media Oversight*, RELAY STATION SOCIAL MEDIA (July 21, 2011) <http://www.relaystationmedia.com/2011/07/massachusetts-securities-division-leads-states-toward-social-media-oversight/>.

<sup>80</sup> *State To Tweet New Social Media Regulations*, SENIOR MARKET ADVISOR (Sept. 1, 2011), <http://www.seniormarketadvisor.com/Issues/2011/September-2011/Pages/State-to-Tweet-new-social-media-reg.aspx>.

<sup>81</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 410 (2010) (codified as amended at 15 U.S.C. 80b-3a(a) (2006)).

<sup>82</sup> Peterson, *supra* note 79.

advisors that are now required to register with a state regulator could be scrutinized more closely by the state securities divisions.<sup>83</sup>

### C. *SEC Document Request*

In early 2011, the SEC reportedly sent out a document request list to investment advisors to assess the use of social media and to determine whether additional “rulemaking and/or examination” resources are needed for a more comprehensive review of its activity.<sup>84</sup> The request reportedly asked for documentation of social media use, policies and procedures for both the business and non-business use of social networking sites, social media training programs, “disciplinary action related to social media,” and record retention policies relating to social media.<sup>85</sup>

### D. *FINRA Enforcement Action*

In its July 2011 *Quarterly Disciplinary Review*, FINRA detailed an enforcement action brought against a registered representative involving misuse of a Twitter account.<sup>86</sup> The registered representative did not notify a principal at her firm that she had a Twitter account with over 1,400 followers, and over the period of a year she posted 32 “tweets” promoting securities.<sup>87</sup> The action claimed that the “the tweets were unbalanced, overly positive and often predicted an imminent price increase.”<sup>88</sup> Additionally, the representative failed to make proper disclosures that her family had an interest in the security that was the subject

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<sup>83</sup> *Id.*

<sup>84</sup> *SEC Begins Sweep on Social Media and Networking*, ACA COMPLIANCE GROUP (Jan. 24, 2011), <http://www.acacompliancegroup.com/news-and-events/?p=24> [hereinafter ACA COMPLIANCE GROUP]; See Hala Touryalai, *SEC Wants to Follow You, On Twitter, Facebook, LinkedIn, YouTube . . .*, FORBES, (Feb. 15, 2011), <http://www.forbes.com/sites/halahtouryalai/2011/02/15/sec-wants-follow-you-on-twitter-facebook-linkedin-youtube/>.

<sup>85</sup> ACA COMPLIANCE GROUP, *supra* note 84.

<sup>86</sup> *FINRA 2011 Quarterly Disciplinary Review*, FIN. INDUSTRY REG. AUTHORITY, 2–3 (Jul. 2011), <http://www.finra.org/Industry/Regulation/Notices/2011/P123914>.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*



of her tweets.<sup>89</sup> This is an example of a bad actor using social media as a tool for fraud. Firms should be aware that as they allow individuals to utilize such sites, there is increased risk of misrepresentation.

#### IV. FINRA NOTICE 11-39

In August 2011, FINRA issued Regulatory Notice 11-39: Social Media Websites and the Use of Personal Devices for Business Communications.<sup>90</sup> FINRA issued this guidance in reaction to many of the questions the financial services industry had raised after Notice 10-06.<sup>91</sup> This Notice provides guidance on “the application of FINRA rules governing communications with the public to social media sites and reminding firms of the recordkeeping, suitability, supervision and content requirements for such communications.”<sup>92</sup> This section will outline and then examine these new guidelines.

##### A. Record-Keeping Guidelines

The Notice first reminds firms generally of their responsibilities under § 17a-4(b)<sup>93</sup> to keep records of business communications for three years.<sup>94</sup> As discussed earlier, these records must be stored for two years in an “easily accessible”

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<sup>89</sup> *Id.* Conduct violated NASD Rules 2210 and 2210-1 (guidelines to ensure that communications with the public are not misleading), and FINRA Rule 2010 (ethical standards). *Id.* FINRA fined the registered representative \$10,000 and suspended her from associating with any member firm in any capacity for one year. *Id.*

<sup>90</sup> See Notice 11-39, *supra* note 21, at 1.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> 17 C.F.R. § 240.17a-4(b)(4) (2011). This regulation states the following: Originals of all communications received and copies of all communications sent . . . by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of a self-regulatory organization of which the member, broker or dealer is a member regarding communications with the public.

*Id.*

<sup>94</sup> Notice 11-39, *supra* note 21, at 2.

location.<sup>95</sup> The communications required to be stored for this period are determined by the content of the communications, not the medium.<sup>96</sup> As long as the communication relates to “business as such,” regardless if it is an email or letter, it is governed by the recordkeeping rules.<sup>97</sup> These record keeping requirements do not differ for static and interactive communications.<sup>98</sup>

The Notice clarifies that communication through social media will be required to also comply with § 17a-4(b) if relating to “business as such.”<sup>99</sup> Determination of whether the communication is related to “business as such” depends on the “facts and the circumstances.”<sup>100</sup> For example, posting biographical information on a website can constitute business communication.<sup>101</sup> If this biographical information includes a list of products and services offered by the firm, these actions would be considered business communications, and therefore subject to record keeping requirements.<sup>102</sup> Also, if a firm allows employees to conduct business communications on a social media site through their own personal device, the firm would be responsible for supervising and keeping record of this communication.<sup>103</sup>

In order to be in compliance with the recordkeeping requirements, the Notice clearly states that a firm may not use any type of technology that “automatically erase[s] or deletes” electronic communication that would prevent compliance with § 17a-4.<sup>104</sup> The Notice also gives a best practices suggestion that as part of compliance programs, firms should educate associated persons on what constitutes business and non-business communication.<sup>105</sup> Additionally, the firm should also provide

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<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 4.

<sup>99</sup> *Id.* at 3.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 4.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 7.

<sup>104</sup> *Id.* at 4.

<sup>105</sup> *Id.* at 3.

training on the steps that associated persons must take to “ensure that any business communication made by associated persons is retained, retrievable, and supervised.”<sup>106</sup>

#### B. *Supervisory Responsibilities Guidelines*

Notice 11-39 also provides important guidance on the firm’s obligation with respect to supervision of employee activity on social media sites.<sup>107</sup> The Notice first reminds firms that under NASD Rule 3010, the rule that governs supervision, each firm must have a compliance system in place that is “designed to achieve compliance with applicable federal securities laws and FINRA rules.”<sup>108</sup> With respect to social media, supervision will require both a review and approval process. First, if an “associated person” plans on using a social media site for a business purpose, a principal at the firm must review it in the form that it will be “launched.”<sup>109</sup> The Notice points out that it is a good practice to additionally require registered principals to review the actual first posting on the site to ensure that it is compliant.<sup>110</sup> After the site is reviewed, the registered principal should approve the communication only if it is determined that the associated person “can and will comply with all applicable FINRA rules.”<sup>111</sup>

The Notice also provides clarity on what type of actions on a social media site—“static” or “interactive”—require approval and review.<sup>112</sup> As discussed earlier, a static post is considered to be an advertisement, thus triggering NASD Rule 2210 and requiring approval by a registered principal before use.<sup>113</sup> For example, an investment advisor who wants to set up a LinkedIn page for a business purpose may first have to get approval for the static parts of the site detailing products and services provided by the firm.

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<sup>106</sup> *Id.*

<sup>107</sup> *Id.* at 2.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 5.

<sup>113</sup> *Id.*

Even if an advertisement has been previously approved, it must be re-approved if any material changes are made.<sup>114</sup>

Interactive communication, such as a posting on a social media site, does not generally have the same supervisory requirements as “static posts.”<sup>115</sup> NASD Rule 2210 provides that “unscripted participation in an interactive electronic forum” is considered a “public appearance” not an advertisement.<sup>116</sup> Associated persons do not have to get prior approval for such communications.<sup>117</sup> However, the Notice warns that these interactive communications could become static, which would trigger the advertisement rules.<sup>118</sup> The Notice gives an illustration of this situation; if an interactive communication is posted and then reposted in a static form on a blog or a website, it is no longer considered interactive and would trigger the rules governing advertisements.<sup>119</sup>

While interactive communications do not trigger pre-approval supervision, the Notice does highlight a best practice approach to how firms can supervise such communication.<sup>120</sup> FINRA suggests that firms use a “riskbased” approach that selectively reviews interactive communication after they have been posted.<sup>121</sup> Firms could utilize “sampling and lexicon-based search methodologies” to screen communication in determining whether violations such as misleading or unbalanced statements have occurred.<sup>122</sup>

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<sup>114</sup> *Id.* at 5 (NASD Rule 2210(c)(8) excludes from the filings requirements any advertisement or sales literature that previously has been filed and that is to be used “without material change”).

<sup>115</sup> *Id.*

<sup>116</sup> *See id.* at 2.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 5.

<sup>119</sup> *Id.*

<sup>120</sup> *See id.* at 2.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

## V. FINRA NOTICE 11-39: IMPLICATIONS FOR SECURITIES INDUSTRY

By issuing Regulatory Notice 11-39, FINRA has given financial firms more concrete guidance on how to structure social media compliance programs. The Notice clarifies FINRA's expectations for firms that choose to utilize emerging technologies. This section will analyze both the benefits of these clarifications, as well as some of the costs associated with it.

### A. *Clarity for the Financial Services Industry*

Regulatory Notice 11-39, combined with Notice 10-06 and the other recent regulatory developments discussed above, could encourage firms to feel more comfortable using social media and similar electronic communication platforms. Social media, when used properly and strategically, can be a key component of a powerful customer on-boarding and relationship management strategy.<sup>123</sup> Particularly in this challenging economic environment, firms can use social media to reach more clients and to grow relationships with existing clients.<sup>124</sup> The securities industry could follow the lead of the insurance and banking industries and implement social media programs.<sup>125</sup> For example, AXA Equitable ("AXA"), a large insurance company, uses software that enables their customers to link information from the AXA website to a variety of social media outlets.<sup>126</sup> TD Bank, one of the ten largest banks in the United States, has seen success when using Twitter for

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<sup>123</sup> See Nathan Golia, *Insurers Leveraging Social Media to Improve Customer Acquisition and Retention*, INS. & TECH. (Feb. 24, 2011), <http://www.insurancetech.com/business-intelligence/229219347>. See generally Daisy Maxey, *The More Friends the Better*, WALL ST. J. (Sept. 19, 2011), <http://online.wsj.com/article/SB10001424053111903461304576524363546220074.html>.

<sup>124</sup> Golia, *supra* note 123.

<sup>125</sup> *Id.*

<sup>126</sup> See Press Release, AXA Equitable, AXA Equitable Launches Breakthrough Social Media Campaign (June 2, 2010), *available at* <http://www.axa-equitable.com/news/2010/axa-equitable-launches-breakthrough-social-media-campaign.html>; Golia, *supra* note 123.

customer service inquires.<sup>127</sup> BNP Paribas, a European bank with operations in eighty countries, opened 12,000 new accounts in two years, in large part through Facebook.<sup>128</sup>

Notice 11-39's further guidance on the use of interactive electronic media may lead registered representatives to become more comfortable participating and interacting with clients through this medium.<sup>129</sup> As discussed earlier, participation in an interactive electronic conversation would be treated as a public appearance, and therefore would not require prior approval from a principal of the firm.<sup>130</sup> If registered representatives are not required to solicit and obtain prior approval from registered principals, they may choose to engage in unscripted communications on social media sites if their firms allow it.

Another likely economic consequence of the increased use by financial services firms of social media platforms is the need for specialized technology solutions to enable firms to meet the regulatory storage and retention requirements. Financial services firms permitting the use of social media by their associated persons will need to employ technology capable of recording at least three years of voluminous communications,<sup>131</sup> much of which occurs through third-party platforms and not their own internal systems.<sup>132</sup> In Notice 10-06, FINRA stated that it does not "endorse any particular" recordkeeping technology for this purpose and went on to state that it is not even "certain that adequate technology

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<sup>127</sup> See John Adams, *New Tool Helps TD Bank Speed Social Media Queries to Reps*, AM. BANKER (Sept. 9, 2011, 12:02 PM), [http://www.americanbanker.com/issues/176\\_176/td-bank-social-media-twitter-1042021-1.html?zkPrintable=1&nopagination=1](http://www.americanbanker.com/issues/176_176/td-bank-social-media-twitter-1042021-1.html?zkPrintable=1&nopagination=1).

<sup>128</sup> See Cristophe Langlois, *How BNP Paribas Drove Customer Acquisition via Facebook on the Anniversary of its Virtual Branch*, VISIBLE-BANKING.COM (Sept. 9, 2011), <http://www.visible-banking.com/2011/09/how-bnp-paribas-virtual-branch-drove-customer-acquisition-via-facebook-on-its-anniversary.html>.

<sup>129</sup> See Notice 11-39, *supra* note 21, at 2.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> See *Id.* at 3, 4, 6.

currently exists.”<sup>133</sup> This unique type of recordkeeping for financial services firms is likely to spur innovation and growth for technology companies looking to capitalize on this market opportunity.<sup>134</sup> For example, as of August 2011, Socialware,<sup>135</sup> a Texas company specializing in the emerging area of “social compliance,” has received over \$14 million in venture capital funding.<sup>136</sup> Socialware provides record-keeping services that assist financial services companies in maintaining compliance with regulatory requirements.<sup>137</sup> Socialware clients include leading financial firms such as “Morgan Stanley, Smith Barney brokerage, American Portfolios, Cambridge Investment Research, Guardian Life, and New York Life.”<sup>138</sup>

Finally, Notice 11-39, together with the prior FINRA guidance, will provide more definite guidelines to assist firms in structuring compliance programs. For example, Fidelity Investments, one of the largest mutual fund companies in the United States, has already expressed this sentiment in its recent comment letter to the SEC.<sup>139</sup> In its August 2011 letter, Fidelity stated that “FINRA’s social media guidance was helpful in supporting securities firms’ participation in, and establishment of social media sites to communicate with investors.”<sup>140</sup>

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<sup>133</sup> See Notice 10-06, *supra* note 54, at 3.

<sup>134</sup> See Tom Steinert-Threlkeld, *Social Compliance Firms Gets \$7M in Funding*, FIN. PLAN. (Aug. 16, 2011), <http://www.financial-planning.com/news/socialware-social-networking-financial-services-compliance-2674660-1.html>.

<sup>135</sup> SOCIALWARE, <http://www.socialware.com> (last visited Oct. 17, 2011).

<sup>136</sup> Steinert-Threlkeld, *supra* note 134.

<sup>137</sup> *Id.*

<sup>138</sup> *Id.* (“As large firms step forward to promote their social media strategies, organizations throughout financial services are now lining up to demonstrate their leadership in the race to social media engagement. . . . This proves the competitive value firms are attributing to social networking.”).

<sup>139</sup> See Letter from Alexander Gavis, FMR LLC Legal Department, to U.S. Sec. & Exch. Comm’n 2 (Aug. 24, 2011), *available at* <http://www.sec.gov/comments/sr-finra-2011-035/finra2011035-6.pdf>.

<sup>140</sup> *Id.*

## B. *Costs*

If firms choose to integrate social media into their marketing or communication strategies, there will be a host of costs associated with recordkeeping and supervisory requirements;<sup>141</sup> as discussed earlier, the additional training that would be required for employees<sup>142</sup> could come at a steep cost. For example, if firms allow registered representatives to communicate with clients and the public through social media, each representative will need to distinguish between communication which requires pre-approval from a principal of the firm, and communication that does not require such pre-approval.<sup>143</sup> If employees are not adequately trained to recognize this distinction, firms may be exposed to violations of the recordkeeping and supervisory requirements. Even if employees are trained to recognize these distinctions, the lack of “clear demarcation between personal and professional communications” on social media sites would in essence create a need to retain all communications, which would be “impractical, unsustainable, and costly.”<sup>144</sup>

The static portions of social media sites may also lead to additional compliance costs, because, as discussed previously, each must be approved by a principal of the firm “in the form in which it will be launched.”<sup>145</sup> Essentially, a principal will be required to review every “static” portion of every registered representative’s social media profile on every site. This would likely create a significant administrative burden for compliance departments at brokerage firms. Consider the previously discussed example of Morgan Stanley and its 17,000 financial advisors; if each one of

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<sup>141</sup> See generally Letter from Dorothy Donohue, Senior Assoc. Counsel of Inv. Co. Inst., to U.S. Sec. & Exch. Comm’n (Aug. 24, 2011), available at <http://www.sec.gov/comments/sr-finra-2011-035/finra2011035-4.pdf>.

<sup>142</sup> See Notice 10-06, *supra* note 54, at 7.

<sup>143</sup> *Id.*

<sup>144</sup> Letter from Dorothy Donohue, *supra* note 141, at 11. See generally Letter from John Polanin and Claire Santaniello, Co-Chairs of Compliance & Regulatory Policy Comm. SIFMA, to U.S. Sec. & Exch. Comm’n (Aug. 25, 2011), available at <http://www.sec.gov/comments/sr-finra-2011-035/finra2011035-8.pdf>.

<sup>145</sup> Notice 11-39, *supra* note 21, at 2.



them creates a LinkedIn profile and the static portion requires pre-approval, one could begin to imagine the scope of the compliance backlog that may result. Then, if a “material change” is made once the profile is launched, the change must also be reviewed by a registered principal.<sup>146</sup> Compounding the problem, there is the potential for ambiguity in determining what would constitute a “material change.”<sup>147</sup>

Firms need to be particularly cautious when it comes to the recommendation of securities over electronic platforms.<sup>148</sup> FINRA Notice 10-06 recommends that firms “consider prohibiting all interactive electronic communications that recommend a specific investment” or “any link to such a recommendation unless a registered principal has previously approved the content.”<sup>149</sup> FINRA also indicates that many firms already retain a database of previously accepted material that registered representatives are permitted to use.<sup>150</sup> Furthermore, FINRA suggests that this material should not include any form of investment recommendation “unless the communication conforms to a pre-approved template and the specific recommendation has been approved by a registered principal.”<sup>151</sup> The underlying message from FINRA strikes an effective balance between addressing the desire of financial firms to leverage emerging technologies and the “seller beware” warning from President Roosevelt.<sup>152</sup>

Lastly, if financial firms start utilizing social media, they should be mindful of potential enforcement actions by FINRA or the SEC. As discussed earlier, when the recordkeeping and supervisory obligations were initially applied to e-mail, there was a

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<sup>146</sup> *Id.* at 5.

<sup>147</sup> *Id.*

<sup>148</sup> See Lois Herzeca, *Social Media and the Federal Securities Laws*, Sec. Reg. & L. Rep. (BNA) 742 (Apr. 4, 2011), available at <http://www.gibsondunn.com/publications/Documents/Herzeca-SocialMediaandtheFederalSecuritiesLaws.pdf>.

<sup>149</sup> *Notice 10-06*, *supra* note 54, at 4.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> Letter from Franklin D. Roosevelt, *supra* note 23.

“long string of proceedings” against firms.<sup>153</sup> In 2006 alone, there were over forty NYSE and NASD disciplinary actions brought against firms for improper email retention.<sup>154</sup> Firms should view these past enforcement actions as a reminder that there are serious financial and reputational consequences for mishandling electronic communications.

## VI. PROPOSED CHANGES TO 2210 AND THE DEBATE MOVING FORWARD

As indicated by the various regulatory changes above, the policing of social media in the financial services industry is an evolving area of regulation. Continuing with this evolutionary pattern, on July 28, 2011, FINRA filed a proposed rule change to NASD 2210 (Communication with the Public) with the SEC.<sup>155</sup> The rule change is currently pending approval by the SEC.<sup>156</sup>

### A. *Proposed Change to NASD Rule 2210*

Under the current NASD Rule 2210, communication with the public is categorized into six groups, each group with its own supervisory and record-keeping requirements.<sup>157</sup> The proposal would reduce the six categories of communication to three— institutional communication,<sup>158</sup> retail communication,<sup>159</sup> and

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<sup>153</sup> Jones & Makens, *supra* note 27, at 159.

<sup>154</sup> *Id.* at 159 n.13.

<sup>155</sup> Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2210, 76 Fed. Reg. 46,870 (proposed August 3, 2011).

<sup>156</sup> *Id.*

<sup>157</sup> *See id.* at 46,871 (showing that under current NASD Rule 2210, the six categories of communication with the public are advertisement, sales literature, correspondence, institutional sales material, independently prepared reprint, and public appearance).

<sup>158</sup> *Id.* (“[W]ritten (including electronic) communications that are distributed or made available to only to institutional investors.”).

<sup>159</sup> *Id.* at 46,872 (“[W]ritten (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period.”).

correspondence.<sup>160</sup> This proposal, as part of an effort to create a “consolidated rulebook,” would streamline the communication approval process.<sup>161</sup>

While the categories may be different, the actual effect on how firms supervise and record social media use may not be that different. The guidance provided by FINRA Regulatory Notices 10-06 and 11-39 with respect to social media largely informs the proposed rules. If the proposed rules are approved, electronic communications distributed to more than twenty-five people would now fall under the category of retail communications.<sup>162</sup> Under proposed Rule 2210(b)(1)(A), communication labeled as retail communication has to be approved prior to use by a registered principal.<sup>163</sup> However, this proposed rule creates an exception for a retail communication that is posted on an online interactive forum.<sup>164</sup> This mirrors the current guidelines offered by FINRA in Notice 10-06 dealing with public appearances. This exception “codifies a current interpretation” of Notice 10-06 “that allows members to supervise communications posted on interactive electronic forums in the same manner as is required for supervising correspondence.”<sup>165</sup> When referring to the static part of the social media site, this would most likely fall under retail communications and would be subject to the review standards as laid out in previous guidelines by FINRA.<sup>166</sup>

## B. *Financial Industry Reaction*

### 1. *Support*

The SEC received nine comment letters to date on the FINRA proposed rule changes, generally indicating that there is a good

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<sup>160</sup> *Id.* (“[W]ritten (including electronic) communication that is distributed or made available to 25 or fewer retail investors within any 30 calendar-day period.”).

<sup>161</sup> *Id.* at 46,870.

<sup>162</sup> *See id.* at 46,872.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> *Id.* at 46,873.

<sup>166</sup> *See generally* Notice 10-06, *supra* note 54.

deal of support for streamlining the categories from six to three.<sup>167</sup> For example, in its August 24, 2011 letter to the SEC, the Investment Company Institute (“ICI”), a national trade association for the financial services industry, put its support behind proposed Rule 2210(b)(1)(D).<sup>168</sup> This is the provision that would exempt from the principal pre-approval requirements Retail Communication that has been posted on an online interactive electronic forum, as long as the company is in compliance with the supervisory requirements of a correspondence.<sup>169</sup> The ICI believes that this is a “good first step in modernizing the regulation of social media [by allowing firms] flexibility to design procedures for overseeing interactive communications appropriate to each firm’s business model and responsive to evolving technology.”<sup>170</sup>

Vanguard, an investment company, is very supportive of exempting certain communications from principal pre-approval, stating, “[w]e believe this approach provides the consistency and flexibility that will be necessary to adapt regulatory requirements to changing technology.”<sup>171</sup> Vanguard also is strongly supportive of both the reduction of communication categories from six to three and the supervisory requirements.<sup>172</sup> Brightscope, a financial information company, strongly supports the proposed changes with regard to the exemption for principal pre-use approval requirements, which are applicable to retail communications of proposed FINRA Rule 2210(b)(1)(A).<sup>173</sup>

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<sup>167</sup> See, e.g., Letter from Dorothy Donohue, *supra* note 141; Letter from Alexander Gavis, *supra* note 139; Letter from John Polanin and Claire Santaniello, *supra* note 144.

<sup>168</sup> Letter from Dorothy Donohue, *supra* note 141, at 8.

<sup>169</sup> Proposed Rule Change to Adopt Rule 2210, *supra* note 155, at 46,873.

<sup>170</sup> Letter from Dorothy Donohue, *supra* note 141, at 9.

<sup>171</sup> Letter from Sandra Burke, Principal of Vanguard, to U.S. Sec & Exch. Comm’n 2 (Aug. 24, 2011), *available at* <http://www.sec.gov/comments/sr-finra-2011-035/finra2011035-5.pdf>.

<sup>172</sup> *Id.*

<sup>173</sup> Letter from Oscar Hackett, General Counsel BrightScope, to U.S. Sec & Exch. Comm’n 1 (Aug. 23, 2011), *available at* <http://www.sec.gov/comments/sr-finra-2011-035/finra2011035.shtml>.

## 2. *Policy Disagreements*

The comment letters raise interesting policy considerations regarding how much regulation is needed in this area, as well as the course for such regulation. Some in the financial services industry, such as ICI, argue that FINRA should have taken a broader, more comprehensive approach to the regulation of social media.<sup>174</sup> In its comment letter to the SEC regarding the proposed rule changes, ICI expressed its desire for a more comprehensive approach to regulation that considers the cost and benefits of recordkeeping responsibilities.<sup>175</sup> ICI also believes that FINRA should reach out to a larger group in the industry to “leverage the industry’s extensive experience with such media.”<sup>176</sup>

Other concerns about the proposed rules, as well as FINRA’s approach to record-keeping responsibilities, revolve around the “massive” amount of data that will be required to be stored and whether such storage benefits investor protection.<sup>177</sup> Fidelity raised this issue in its comment letter to the SEC, pointing out that social media communication is often-times comprised of “disjointed short phrases” the meaning of which can be difficult to decipher.<sup>178</sup> Fidelity reasoned that “given the amount of content . . . discovery of issues relating to investor protection concerns may be difficult and impossible, analogous to searching for a needle in a haystack.”<sup>179</sup>

Another issue raised by the comment letters involves FINRA’s disposal of the “public appearance” as a unique category of communication.<sup>180</sup> Some members of the financial services industry expressed concern that without a separate category that addresses appearance in an online interactive forum, there would be little flexibility for rule changes as technology evolves.<sup>181</sup> The

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<sup>174</sup> Letter from Dorothy Donohue, *supra* note 141, at 11.

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> Letter from Alexander Gavis, *supra* note 139, at 10.

<sup>178</sup> *Id.* at 9.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.* at 8.

<sup>181</sup> *Id.*

practical implication of this change is that if a rule relating to social media needs to be amended, all three categories of communication that address social media will have to be modified. To avoid this issue, Fidelity suggests to the SEC that there should be a fourth category specifically for Electronic Communications.<sup>182</sup>

Some members of the industry requested that the exemption from pre-approval should also include certain retail communications with recommendations.<sup>183</sup> The Securities Industry and Financial Market Association (“SIFMA”), in its comment letter to the SEC, argues that without such an exemption almost every post would have to be previewed to see if NASD 2210(c)(2)(3) were triggered.<sup>184</sup> For example, SIFMA points out that any discussion of mutual funds on a social media site may trigger a “filing requirement.”<sup>185</sup>

### C. Policy Implications

In its comment letter to the SEC, SIFMA astutely points out that the proposed changes to the communication categories will focus attention on the “recipient of the communication” rather than the “form of communication.”<sup>186</sup> All communications, no matter the medium, will be treated in a similar manner based on the recipient. For example, all communication to an institutional audience would have one rule and all communication to a retail investor would have another rule—it would be irrelevant if that communication occurs on a social media site or by email. By limiting all communications to just three categories, FINRA is broadening the flexibility of fitting new technologies into a proper regulatory box. As new methods of communication evolve, firms may feel comfortable utilizing them with the knowledge that recordkeeping responsibilities are dependent on who is reading the

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<sup>182</sup> *Id.*

<sup>183</sup> Letter from John Polanin and Claire Santaniello, *supra* note 144, at 6.

<sup>184</sup> *Id.*

<sup>185</sup> *Id.* (“A rule that effectively requires the review of 100% of a member's postings in an online interactive forum would create a high—and perhaps insurmountable—obstacle to its ability to communicate with customers in their desired fora.”).

<sup>186</sup> *Id.* at 2.

communication, not how they are reading it. This may prove to be a very forward-thinking guideline.

FINRA's decision to exempt principal approval requirements for certain posts on interactive online fora<sup>187</sup> demonstrates that it is taking a realistic approach to regulation. It suggests that FINRA recognizes that if it is going to allow firms to use social media, financial services firms actually need to be able to communicate without stopping to obtain approval before each tweet. Allowing firms to avoid the pre-approval process in certain circumstances provides a healthy amount of flexibility; FINRA has given firms the leeway to comply with NASD Rule 3010 in a "manner reasonably designed to ensure that they do not violate the content requirements of communication rules."<sup>188</sup> However, when it comes to recommendations of securities, FINRA correctly institutes a requirement for increased firm supervisory responsibility. Ultimately, FINRA's approach strikes a healthy balance between allowing flexible communications and limiting the potential risk to investors.

Lastly, while the ICI suggests that a comprehensive approach to regulating social media would be useful to financial services firms,<sup>189</sup> it is simply not practical. With the rapid changes in technology, it would be impossible to create a comprehensive set of regulations that would encompass every type of social media communication. As soon as such a regulatory scheme was voted on, it could be outdated by a new technology.

## VII. CONCLUSION

Social media presents both opportunities and risks for the financial services industry. With this in mind, FINRA is correct to

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<sup>187</sup> NASD Rule 2210(c)(7), available at [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=10467&element\\_id=3617&highlight=2210#r10467](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=10467&element_id=3617&highlight=2210#r10467).

<sup>188</sup> Notice 10-06, *supra* note 54, at 6 (explaining that firms may employ risk-based principles to determine the extent to which the review of incoming, outgoing, and internal electronic communication is necessary for proper supervision).

<sup>189</sup> Letter from Dorothy Donohue, *supra* note 141, at 11.

regulate the use of social media by financial services firms and their employees in order to protect investors. FINRA has taken a levelheaded approach toward regulation in this area by providing guidelines, proposing incremental rule changes, and soliciting input from financial services firms. FINRA's approach to regulating these constantly evolving technologies is likely to enable firms to leverage powerful new communications tools to better interact with and service their clients.



