BE CAREFUL WHAT YOU POST - SEC CONTINUES TO FOCUS ON THE USE OF SOCIAL MEDIA BY INVESTMENT ADVISERS

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On July 10, 2018, the Securities and Exchange Commission (the “SEC”) reaffirmed the application of the securities laws to social media use. Specifically, the SEC published five settlement orders (the “Settlements”) [1] arising from alleged violations of the Investment Advisers Act of 1940, as amended (“Advisers Act”), and Rule 206(4)-1(a)(1) thereunder (the “Testimonial Rule”). Notably, the Settlements involved the publication of client testimonials on social media and other websites by SEC-registered investment advisers (“RIAs”), the investment adviser representatives of RIAs (“IARs”), and/or a marketing consultant hired by the RIA or the IARs. Taken together, the Settlements demonstrate that the SEC and its staff (“Staff”) are actively applying the Staff's 2014 Guidance on the Testimonial Rule (described below) in the enforcement context. The Settlements, which arise from examination referrals conducted by the SEC's Chicago Regional Office, are further evidence of an increased focus by the Staff on social media use by RIAs generally. [2]

INVESTMENT ADVISER ADVERTISING AND SOCIAL MEDIA: THE BIG PICTURE

Section 206(4) of the Advisers Act makes it unlawful for an RIA to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative, and Rule 206(4)-1 under the Advisers Act identifies and effectively prohibits certain statements that, when published in an advertisement by an RIA, constitute a violation of the Act. One of these prohibitions, the Testimonial Rule, prohibits the use of “any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser.” [3]

RIAs face certain challenges applying Rule 206(4)-1, which was originally adopted in 1961 and has not been substantively amended, to modern forms of communication. [4] The definition of an “advertisement” subject to the rule, for example, is extremely broad and has been interpreted to encompass certain statements by the RIA and its personnel on social media, and even statements by third parties on social media where the RIA has some involvement in the social media site or the production of its content. Likewise, the term “testimonial” is not defined in the rule or elsewhere in the Advisers Act; the Staff has consistently interpreted that term to include a “statement of a client's experience with, or endorsement of, an investment adviser.” [5] In a 2012 risk alert, the Staff stated its view that “nearly any social media website maintained by an investment adviser” would constitute an “advertisement,” and that the mere use of “social plug-ins” such as a “like” button, could constitute a testimonial prohibited by the Testimonial Rule. [6]

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On March 28, 2014, the Staff published a guidance update ("2014 Guidance") addressing, among other issues, the solicitation of client testimonials by RIAs for inclusion on social media websites. [7] The 2014 Guidance removed a great deal of then-existing uncertainty regarding RIA social media use by acknowledging that not all public commentary posted on a social media website constitutes a prohibited testimonial. The 2014 Guidance stated that, in the Staff's view, public commentary made directly by a client about his or her own experience with, or endorsement of, an RIA *could* be a testimonial if the RIA played a role, directly or indirectly, in obtaining or requesting the commentary. [8] Specifically, the Staff noted that invitations to clients to post commentary on an RIA's internet site, blog or social media site would render any response an impermissible testimonial.

The Settlements show that the SEC is committed to enforcing the principles in the 2014 Guidance.

THE RECENT SETTLEMENTS

According to the Settlements, two RIAs, three IARs, and a marketing consultant published testimonial advertisements on the internet in violation of the Testimonial Rule. The Settlements found that as a result of the conduct described below, the RIAs each violated, and that the IARs and the marketing consultant each caused violations of, Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(1) thereunder.

More specifically, one of the Settlements alleges that an RIA published two videos containing client testimonials on both the RIA's public website and YouTube.com. The testimonials used in the videos included statements that the RIA's services had provided the clients with income, security, and peace.

Three of the other Settlements allege that an RIA and its IAR, as well as two IARs employed by other investment advisers not included as parties to the actions, hired a marketing consultant and his company, Create Your Fate, LLC ("Create Your Fate"), to solicit testimonials from clients, which were then published on various social media and other websites. The fifth Settlement was directly against the marketing consultant, who was not an RIA or an IAR. The testimonials included statements indicating the RIA and IARs were knowledgeable and trustworthy, helped clients generate investment returns, enabled the client to access unique investment opportunities, and protected the client's investments from risk. Create Your Fate published a number of these testimonials on the RIA's and IARs' social media websites. Create Your Fate used the solicited testimonials in videos captioned "Five Star Review," which were posted to YouTube and the RIA's and IARs' public websites. The videos included the contact information and a link to the settling RIA's and IARs' websites. The Settlements also allege that one of the RIAs orally solicited clients and other individuals to publish testimonials directly on independent social media websites like Yelp.

PRACTICAL IMPLICATIONS

a. Videos, Podcasts, and similar media are "advertisements" subject to the Testimonial Rule.

One of the Settlements involved a fairly straightforward fact pattern. The SEC alleged that the settling RIA published two videos on its website and on YouTube. These videos were deemed "advertisements" that contained client testimonials discussing the RIA and the advice and services it renders, and thus violations of the Testimonial Rule.

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RIAs should be mindful when creating content that website videos and other media such as podcasts are considered “advertisements” and, to the extent they contain client testimonials, may violate the Testimonial Rule.

b. The SEC is enforcing the 2014 Guidance on social media content.

The Settlements also present a more complicated question: Will an RIA be held responsible for statements made by third parties on social media? With these Settlements, the answer appears to be that the SEC is taking a more active approach to enforcement of statements made by and about RIAs on social media, consistent with the principles in the 2014 Guidance.

The 2014 Guidance squarely addresses the fact pattern in these Settlements: “if an investment adviser or IAR invited clients to post . . . public commentary directly on the investment adviser's own internet site, blog or social media website that served as an advertisement for the investment adviser or IAR's advisory services, such testimonials would not be permissible.”

It should be noted that not all testimonials posted to social media regarding an RIA or its personnel are deemed impermissible under the 2014 Guidance. The 2014 Guidance establishes certain standards for determining whether commentary published on a social media site is sufficiently independent of influence by an RIA or its IARs such that the commentary should not be deemed to implicate the Testimonial Rule. Here, the commentary was not considered sufficiently independent because the RIA and IARs directly and indirectly solicited the commentary. RIAs should note that invitation or solicitation is only one way that third party social media commentary may be deemed an impermissible testimonial. RIAs should review the 2014 Guidance to ensure that they do not take other actions that may render otherwise independent social media commentary suspect in the eyes of the Staff, such as removing unfavorable comments or submitting false testimonials. [9]

OTHER INDICATIONS THE REGULATION OF RIA'S USE OF SOCIAL MEDIA IS A STAFF PRIORITY.

These Settlements are only one indication of an increased focus by the Staff on RIAs' social media use, which is likely a reaction to the increased use of social media by both investors and RIAs. Other actions over the past two years also show a growing level of attention to RIA social media websites by the SEC and its Staff.

For example, recent amendments to Form ADV now require that RIAs disclose additional information regarding their use of social media. [10] Specifically, RIAs must now disclose the website addresses of each account maintained by the RIA on publicly available social media platforms, such as Twitter, Facebook, and LinkedIn. Prior to these amendments, Form ADV only requested disclosure of the RIA's own website, but not its social media pages. In the adopting release for these amendments, the Staff noted that, given the rapidly evolving social media environment, Staff access to additional information regarding RIA use of social media is of particular importance.

In addition, the Office of Compliance Inspections and Examinations of the SEC (“OCIE”) undertook a series of nearly 70 sweep examinations focused on certain RIA advertising issues, including the use of testimonials, beginning in 2016. [11] The results from this initiative confirmed that RIAs frequently include client statements describing RIA services and/or endorsements in advertisements, including firm websites and social media pages. In light of the SEC's focus and the expansion of the use of social media in the investment management industry,

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RIAs should prepare for more frequent and detailed reviews of RIAs' websites and social media pages as part of the OCIE examination process.

For prior alerts on this topic see:

Amendments to Form ADV: Practical Considerations, http://www.klgates.com/amendments-to-form-adv-practical-considerations-09-27-2017/

Calm Before the Storm: Investment Advisers Face Changes to the Advertising Rule, GIPS, and Performance Portability Standards, http://www.klgates.com/calm-before-the-storm-investment-advisers-face-changes-to-the-advertising-rule-gips-and-performance-portability-standards-05-23-2018/

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[1] *In the Matter of William M. Greenfield*, Investment Advisers Act Rel. No. 4961 (Jul. 10, 2018); *In the Matter of Brian S. Eyster*, Investment Advisers Act Rel. No. 4962 (Jul. 10, 2018); I*n the Matter of HBA Advisors, LLC and Jaime Enrique Biel*, Investment Advisers Act Rel. No. 4963 (Jul. 10, 2018); *In the Matter of Leonard S. Schwartz*, Investment Advisers Act Release No. 4964 (Jul. 10, 2018); *In the Matter of Romano Brothers & Company,* Investment Advisers Act Rel. No. 4965 (Jul. 10, 2018) (collectively, the "Settlement Actions").

[2] *See Form ADV and Investment Advisers Act Rules*, Release No. IA-4509, SEC (Aug. 25, 2016) ("Form ADV Amendments"); see also http://www.klgates.com/amendments-to-form-adv-practical-considerations-09-27-2017/; The *Most Frequent Advertising Rule Compliance Issues Identified in OCIE Examinations of Investment Advisers*, National Examination Risk Alert, Office of Compliance Inspections and Examinations, SEC, Vol. VI, Issue 6 (Sept. 4, 2017) (the "2017 Risk Alert").

[3] *See* the Testimonial Rule, "[i]t shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business… for any investment adviser registered or required to be registered under [the Advisers Act], directly or indirectly, to publish, circulate, or distribute any advertisement which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser."

[4] SEC staff have recently expressed an intent to revise Rule 206(4)-1, and the rule is on the SEC's short-term regulatory agenda. *See* http://www.klgates.com/calm-before-the-storm-investment-advisers-face-changes-to-the-advertising-rule-gips-and-performance-portability-standards-05-23-2018/.

[5] *See* Cambiar Investors, Inc. Staff No-Action Letter (pub. avail. Aug. 28, 1997).

[6] *Investment Adviser Use of Social Media*, National Examination Risk Alert, Office of Compliance Inspections and Examinations, SEC, Vol. 1, Issue 1 (Jan. 4, 2012).

[7] *Guidance on the Testimonial Rule and Social Media,* Guidance Update, Division of Investment Management, SEC, No. 2014-04 (March 2014);

[8] *See* DALBAR, Inc., Staff No-Action Letter (pub. avail. March 24, 1998).

[9] *See Guidance on the Testimonial Rule and Social Media*, supra note 7.

[10] *See* Form ADV Item I.1.

[11] *See* 2017 Risk Alert, *supra* note 2.

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