

The key to compliance

New Finra guidance highlights to US broker-dealers the importance of establishing detailed social media policies and procedures

On August 18, 2011, the Financial Industry Regulatory Authority, Inc (Finra) issued Regulatory Notice 11-39 providing guidance to its broker-dealer members on social networking websites and business communications.

The notice represents Finra's first update to its guidance on social media since the release of Regulatory Notice 10-06 in January 2010. Regulatory Notice 10-06 provides guidance on the application of Finra rules governing communications by Finra member firms with the public through social media sites, and reminds member firms of certain requirements relating to those communications.

According to Finra, Regulatory Notice 11-39 was issued to respond to questions raised by firms after Finra issued Regulatory Notice 10-06, and to clarify the application of Finra's rules to social media technologies. The notice includes a series of questions and answers relating to longstanding Finra regulations governing communications, and new applications thereof.

As noted by Finra, Regulatory Notice 11-39 clarifies existing guidance; it does not introduce new principles to the existing regulatory framework. Accordingly, Regulatory Notice 11-39 is not likely to result in major changes to current social media policies of member firms.

Background

To understand the guidance, it is important to understand the difference between static and interactive electronic communications. Since 1999, Finra has taken the position that participation by a registered representative of a member firm in an internet chat room is comparable to a presentation made to a group of investors and, accordingly, is subject to the same rules applicable to presentations.

This position was codified in 2003 when NASD Rule 2210 was amended to include the participation in an interactive electronic forum in the definition of public

appearance. Hence, the Finra rules do not require prior approval of postings by member firms or their associated persons on interactive electronic forums.

Static communications or postings are regulated as advertisements under the Finra rules and, accordingly, are required to have been reviewed by a registered principal. Member firms and their associated persons must be careful to distinguish between static and interactive electronic communications.

A new Rule 2210 has been proposed by Finra but is not yet in effect. Under the new rule, advertisements to more than 25 retail investors in a 30-calendar day period will be deemed retail communications and, accordingly, subject to prior review.

The term "public appearance" will no longer be part of the rule but the substantive treatment of public appearances under the rules will, for the most part, remain unchanged. Participation in an interactive electronic forum will continue to be allowed without prior approval.

Recordkeeping

The first category of regulations addressed in Regulatory Notice 11-39 is recordkeeping. Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 and NASD Rule 3110 have long required that a broker-dealer retain electronic communications made by the firm and associated persons that relate to the firm's business as such (that is, business communications).

In Regulatory Notice 11-39, Finra clarified a number of issues relating to these recordkeeping requirements and the use of social media. The posting of any content on a website by a member firm or its associated persons is a communication under the Finra rules and, accordingly, is subject to applicable Finra recordkeeping requirements.

According to Finra, the determination of whether an electronic communication is related to a firm's business as such, and hence, subject to the recordkeeping rules,

depends on the facts and circumstances and the context and the contents of the communication. Neither the type of device or technology used to transmit the communication nor the ownership of the device is relevant to the determination.

Finally, with respect to recordkeeping rules, the requirements are the same for both static and interactive electronic communications.

Analysing a communication based on the facts and circumstances and context is an inherently subjective test. Firms will need to adopt clear internal policies to assist their associated persons in determining whether a communication is related to a firm's business.

Finra notes that autobiographical information, such as location of employment and job responsibilities, might not be a business communication when included in a resume sent to a potential employer.

However, listing products and services provided by a firm generally would constitute a business communication. Finra stressed that member firms must develop policies and procedures that include training regarding the differences between business and non-business communications.

Firms are well advised to focus carefully on the principles they adopt. Compliance departments must guide their personnel through the subjective nature of these determinations rather than leaving it to the discretion of individual associated persons or a case-by-case basis.

Finra cautions member firms that neither they nor their associated persons may sponsor media sites or use communication devices that automatically erase or delete content. The automatic deletion of content precludes compliance by firms with the recordkeeping obligations.

Finra also cautions that although third-party posts are generally not deemed to be a firm's or an associated person's communications, the recordkeeping rules require retention of communications received by a firm or an associated person relating to its business as such and thus, third-party posts may be subject to recordkeeping obligations.

Firms will need to make sure their associated persons that maintain social media sites either ensure the sites are not used for business purposes, which determination must be guided by both Finra rules and firm policies, and that such associated persons have adequate training and education regarding third-party posts and Finra rules and firm policies.

If the particular social media sites have the relevant compatibility, firms should consider requiring that associated persons include static legends on their media sites warning the reader that neither the applicable member firm nor the associated person is responsible for third-party content.

Supervision

A second category of regulation addressed in Regulatory Notice 11-39 is supervision.

NASD Rule 3010 provides that member firms must establish and maintain a system to supervise the activities of each registered representative, registered principal and other associated person, and that the system must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable Finra rules.

If an associated person wants to use a social media site for business purposes, Finra rules require that a registered principal should review the site prior to its use, to the extent that the content is static.

A site should only be approved for use for business purposes if the registered principal has determined that the associated person can and will comply with all applicable Finra communication rules, federal securities laws and individual firm policies.

Finra notes that a registered principal must review an associated person's proposed social media site in the form in which it will be launched and explains that some firms require review by a registered principal of the associated person's initial posting on an interactive forum within the site.

Postings on an interactive forum generally do not require prior approval under Finra rules but, according to Finra, review of the initial post allows the registered principal to review the site in its final design. Member firms should continue to supervise the site, from time-to-time, for compliance with applicable rules and federal securities laws after launch.

Finra's guidance regarding supervision highlights the need for proactive efforts by compliance departments. If firms intend to allow their associated persons to use social media for business purposes, detailed policies and diligent training is essential.

Finra explained that interactive content may become static through different acts and that would change the treatment of such communications under the rules; for example by taking a comment on a Facebook post and copying it as a static Facebook post on a Facebook profile.

Finra also cautioned firms that, as with any other advertisement under Finra rules, a registered principal must review all material changes to previously approved static posts. Associated persons will need to monitor their sites and registered principals must supervise appropriately to ensure continued compliance.

One exception noted by Finra relates to statistical data presented in static form and regulated as an advertisement. Existing

“Member firms should consider prohibiting associated persons from soliciting recommendations on sites such as LinkedIn”

Finra rules allow a member firm to approve in advance a template used to present statistical data but do not require prior approval of the data fed into the template from time to time.

Finra cautions that when doing so, a member firm must have procedures that are reasonably designed to ensure that the data may be verified, is timely and accurate and that the firm promptly corrects data that was incorrect when posted or becomes inaccurate over time.

Finra also cautions that a firm must follow-up on red flags that indicate non-compliance by its associated persons. Finra explained that some firms require that associated persons certify annually, or more frequently, that they are in compliance with supervision rules. It also explained that some firms perform random spot checks of websites to monitor firm policy compliance.

Links to third-party sites

Regulatory Notice 11-39 also addresses the potential liabilities associated with third-party posts. Finra explains that a firm may not establish links to third-party sites that the firm knows, or has reason to know, contain false or misleading content, and should not do so when there are red flags to that effect.

Further, Finra advises that under applicable communication rules, a firm may become responsible for content on third-party sites if the firm has adopted or becomes entangled with the content on the third-party sites. A firm may be deemed to be entangled with a third-party site if, for

example, the firm participates in the development of content on the third-party site.

Also, a firm may be deemed to adopt third-party content if it indicates on its site that it endorses the content on the third-party site. Many social media sites, such as LinkedIn, allow third parties to recommend a person and allow users to request recommendations.

Member firms should consider

prohibiting associated persons from soliciting recommendations. Otherwise, the firm may be deemed to have adopted the third-party recommendation.

This guidance is consistent with guidance issued by the US Securities and Exchange Commission with respect to third-party information that is hyperlinked to a public company's site.

Firms should make sure that any links to third-party sites are only accessible through a new window when linking to a site, and that a legend appears on the screen warning the reader that he or she is leaving the firm site and disclaiming any responsibility for third-party content.

It is unlikely that such legends will shield a member firm from sanction by Finra, if applicable, but posting such legends may be effective for limiting liability relating to customer claims. Firms should also make sure that their policies relating to social media sites address links to third-party sites.

Third-party posts, links and websites

In addition to adoption and entanglement, if a member firm co-brands a third-party site, it will effectively adopt the content of the entire site.

A member firm may co-brand a site by, among other things, placing the firm's logo prominently on the site.

Finra explains that an associated person may respond to business-related posts by a third-party on the associated person's personal social media site as long as the associated person's firm does not have a

policy prohibiting the use of personal social media sites for business purposes. This principle applies to all business-related, but not personal posts.

For example, the associated person may respond to questions regarding securities through his or her site unless prohibited by the applicable member firm.

Finra notes that some firms allow their associated persons to post a non-substantive response to a third-party post and allow pre-approved statements that associated persons may use as a response that direct the third-party to a firm-approved communications medium, such as the firm's e-mail system.

Finra also provides some comfort for firms that have a policy of deleting inappropriate third-party content.

A firm that has a policy of routinely blocking or deleting certain types of content will not be deemed to have adopted similar content that was neither blocked nor deleted.

Data feeds

Finra cautions that firms must manage data feeds inputted into their websites.

As data feeds may contain inaccurate data, firms must be familiar with the proficiency of the vendor providing the data and its ability to provide accurate data.

Managing data feeds involves understanding the criteria used by vendors in collecting or calculating the data, regular review of the data for red flags and promptly taking necessary measures to correct any inaccurate data.

Accessing social media from personal devices

Finra explains that firms may permit their associated persons to use personal communication devices to access firm business applications and to perform firm business activity. However, Finra cautions that a firm must be able to retain, retrieve and supervise business communications regardless of the ownership of the device used to transmit the communications.

According to Finra, it is a good idea for a firm to require that, if possible, separate applications on a device be used for business communications to facilitate retrieval of the business communications without retrieving personal communications.

Finra also notes that an application that provides a secure portal into a firm's communications system is preferable, especially if confidential customer information is shared. If a firm has the ability to separate business and personal communications on a device, and has adequate policies and procedures regarding usage, the firm will not be required to (but may voluntarily) supervise personal communications on the device.

Firms should consider what devices are most compatible with their internal compliance efforts and require associated persons to limit their business communications to such devices. To facilitate retrieval, it is advisable to ask associated persons to limit personal communications to private e-mail accounts and to prohibit business communications through firm e-mail accounts.

Training is key

Although the use of social media by member firms is rising, many firms may remain hesitant to adopt broad social media policies despite the new guidance.

The guidance in Regulatory Notice 11-39 is not comprehensive enough to encourage significant changes in that regard.

Nonetheless, the new guidance is important in that it serves to reaffirm Finra's general expectations of member firms with respect to business communications.

Finra stressed repeatedly that member firms must have policies and procedures in place that cover the firms' compliance efforts with the communication rules, and that the policies and procedures must include training and education.

Of course, the firms' training and education must include training on the firms' policies relating to social media and the need to continuously monitor such sites.

Firms should also consider continuous refresher courses for their associated persons to make sure they remain vigilant of the need to consider how continuously changing technologies may be treated under the rules.

The greater the training and education, the more firms may become comfortable in taking advantage of the social media resources available.

By of counsel Joseph R Magnas and associate Hashem Sabbagh of Morrison & Foerster in New York

Reprints of any article are available on request

For more information please contact
Claudia Tan
 Tel: +44 20 7779 8637
 Fax: +44 20 7246 5206
 E-mail: ctan@legalmediagroup.com

The advertisement features a blue background with a man's face in the foreground. Behind him is a cover of the IFLR magazine. The magazine cover has the title 'IFLR' at the top, followed by 'Europe rules' and 'Esma's head, Steven Maijoor on his change of philosophy'. There is also a 'SURVEY' badge in the bottom right corner of the magazine cover.