


Managing Legal Liability in Social Media

Securities

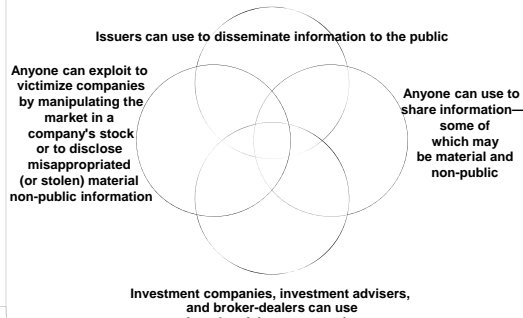


Securities Markets and Market Participants Have Always Embraced Technology

Social Media Is Simply the Newest Iteration



How Social Media and Securities Markets Intersect




Issuers can use to disseminate information to the public

Anyone can exploit to victimize companies by manipulating the market in a company's stock or to disclose misappropriated (or stolen) material non-public information


Anyone can use to share information—some of which may be material and non-public

Investment companies, investment advisers, and broker-dealers can use for advertising or promotion



Disseminating Information

- SEC moving toward recognizing more channels of distribution for required and other public information disclosures, including a variety of electronic media
- As technologies expand, SEC has acknowledged that it will continue to recognize new channels of distribution as appropriate for such disclosures



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The Law of Fair Disclosure

- Regulation FD governs public disclosures of material information (largely by issuers of securities) and requires that such information be disseminated by methods “reasonably designed to provide broad, non-exclusionary distribution of the information to the public”

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Using the Internet and Social Media for Disclosures

- A few companies are moving toward exclusively providing disclosure via their websites
- Supplementing other forms of disclosure with social media may be an effective strategy, if done with care

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Advertising and Promotion

- Social media is an inexpensive and effective way to communicate with clients and prospects **BUT...**
- if the promotion or disclosure is held to be inadequate or otherwise violates regulatory requirements, it could result in an investigation or action by regulatory authorities
- regulated persons and entities must obtain proper compliance officer approvals before using social media

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Some Applicable Authority for Advertising and Promotion

- **Registered representatives/broker-dealers:** Financial Institution Regulatory Authority (FINRA) regulations and guidance, as well as approval from compliance department
- **Registered investment advisers:** SEC rules, like Rule 206(4)-1, *et seq.* under the Investment Advisers Act of 1940, which governs advertising, as well as compliance officer/department

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Suitability Responsibilities

- Under NASD Rule 2310, a recommendation of a security must be suitable for every investor to whom it is made

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Supervisory Duties of Broker-Dealers

- Compliance policies and procedures must be designed to prevent registered representatives from making improper communications, even “on their own time”

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Third-Party Posts, Links, and Data Feeds

- Third-party posts are not attributed to a financial firm hosting them, unless there is “entanglement” or “adoption”
- Links to third-party content: notice of inaccuracy, including red flags
- Third-party data feeds: affirmative duties to vet and monitor

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Registered Investment Advisers (RIAs)

- The federal securities laws and SEC rules subject RIAs to similar content and record-keeping requirements as those just discussed
- If RIAs’ communications are deemed “advertisements,” they are subject to Rule 206(4)-1 under the Investment Advisers Act of 1940

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Rule 206(4)-1 Under the Investment Advisers Act

- Testimonials Prohibited
- False or Misleading Advertisements Prohibited

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Compliance Policies and Procedures for RIAs

- The level of social media engagement an RIA should allow depends on a balancing of risks and benefits
- In any case, monitoring is critical

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Remember the SEC is Watching... and Tweeting!

- One of the SEC's very first Tweets discussed a recent enforcement action against a Registered Investment Adviser
- Given the SEC's newfound technological savvy, if the SEC is active on Twitter, then it certainly knows how to troll the most popular social media sites looking for compliance violations



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Insider Trading Concerns

- The “stock in trade” of social media is the communication of information
- Some information conveyed could be material, non-public information – whether intentional or otherwise
- The transmission of material, non-public information, if it breaches a duty to the company or to the person who shared it, may be a violation of the securities laws, and trading on such information very likely represents insider trading
- This conduct is regulated largely through the antifraud provisions, but most often Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, thereunder

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Stepped-Up Surveillance of Insider Trading

- Improved enforcement tools
- Increased enforcement pressure

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Unregistered, Nonexempt Offerings

- The spontaneity of social media creates new pitfalls for the uninformed
- Unsophisticated parties may make an unlawful offering without realizing that they are involved with securities at all

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Unregistered, Nonexempt Offerings

- Reform is on the horizon, but pitfalls remain

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Market Manipulation Through Social Media

- Information posted through social media can expose companies to regulatory investigations and legal claims, and expose companies' securities to manipulation by those who would intentionally exploit the media for unlawful activity
- Companies should assure that sites, pages and other outlets for discussion and dispersal of information are being properly and lawfully used
- The SEC has announced its intention to pursue "false rumor" cases – just one variety of market manipulation – and social media outlets are perfect places for such rumors to grow and impact stock prices

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CONCLUSIONS

- Social media provides huge opportunities and enormous pitfalls.
- The regulators are still finding their way.
- Due care is warranted – and mandated under the regulatory schemes.

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