

SEC Issues New Guidance for Investment Advisers Regarding Use of Social Media Testimonials

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On March 31, 2014, the Division of Investment Management (the “Division”) of the Securities and Exchange Commission (the “SEC”) issued long-awaited guidance regarding investment advisers’ use of public commentaries on social media and their own websites.¹ Recognizing the increased use of social media and the Internet to research and diligence service providers, the Division seeks to help advisers apply Section 206(4) of the Investment Advisers Act of 1940 (as amended, the “Advisers Act”) and Rule 206(4)-1(a)(1) thereunder (the “testimonial rule”) to their use of social media testimonials from independent third parties.

Background

Section 206(4) of the Advisers Act prohibits an investment adviser from “engag[ing] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative,” and directs the SEC to prescribe rules “reasonably designed to prevent” the same.² In particular, the testimonial rule states that:

It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the [Advisers Act] for any investment adviser registered or required to be registered under Section 203 of the [Advisers Act], directly or indirectly, to publish, circulate, or distribute any advertisement [w]hich 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.³

Although the rule does not define “testimonial,” the Update notes that the SEC staff has consistently interpreted the term “to include a ‘statement of a client’s experience with, or endorsement of, an investment adviser.’”⁴ For example, an adviser’s publication of commentary that is a statement of a client’s experience with or endorsement of the adviser on the adviser’s website, blog or social media site would violate the testimonial rule and historically has been prohibited.⁵ On the other hand, an adviser’s publication of an article by an independent, unbiased third party regarding the adviser’s investment performance is not a testimonial if it does not include a statement of a client’s experience with or endorsement of the adviser.⁶

New Guidance

In a Q&A format, the Update lays out the Division’s new position on when an investment adviser or an investment advisory representative (an “IAR”) may publish advertisements that feature public commentary about them without violating the testimonial rule. In general, whether public commentary on a social media site is a testimonial depends upon all of the facts and circumstances relating to the statement. However, publication⁷ of third-party commentary from an “Independent Social Media Site”⁸ would not raise the dangers the testimonial rule was designed to prevent if each of the following three conditions is satisfied:⁹

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	Condition	Notes
1. Independence	The Independent Social Media Site provides content that is independent of the adviser or IAR.	This condition is not satisfied if the adviser or IAR directly or indirectly authors or submits commentary that appears on the Independent Social Media Site. ¹⁰
2. No Material Connection	There is no material connection between the Independent Social Media Site and the adviser or IAR that would call into question the independence of the Independent Social Media Site or commentary.	<p>This condition is not satisfied if the adviser or IAR directly or indirectly authors or submits commentary that appears on the Independent Social Media Site.¹¹</p> <p>However, an adviser or IAR may advertise with the Independent Social Media Site, provided it is readily apparent to a reader that (i) the advertisement is separate from the public commentary featured on the Independent Social Media Site and (ii) the receipt or nonreceipt of advertising revenue did not in any way influence which public commentary is included or excluded from such site.¹²</p>
3. Full Disclosure of All Comments	The adviser or IAR must publish all the unedited comments appearing on the Independent Social Media Site regarding the adviser or IAR.	<p>The adviser or IAR may not delete or hide negative comments.</p> <p>The publication must be in a content-neutral manner (e.g., chronological or alphabetical order), presenting positive and negative commentary with equal prominence.¹³</p>

To facilitate review of the commentaries, adviser and IAR sites may provide a “sorting mechanism,” as long as the adviser or IAR site does not itself sort them.¹⁴ Adviser and IAR sites also may include a mathematical average of the commentaries, as long as (i) commenters themselves rate the advisers or IARs “based on a ratings system that is not designed to elicit any pre-determined results that could benefit any investment adviser or IAR” and (ii) the Independent Social Media Site, the adviser and the IAR do not include any subjective analysis or other summary of the public commentary.¹⁵ The

Division cautions that subjective analyses may be prohibited more broadly (*i.e.*, any subjective analysis or other summary of the public commentaries may implicate the testimonial rule).¹⁶

On nonsocial media (*e.g.*, newspaper, television) advertisements, an adviser or IAR may reference the name and/or logo of Independent Social Media Sites, but may not publish any public commentaries from the site.¹⁷

Among other new guidance, the Update includes the following:

- A list of “friends” or “contacts” on an adviser’s or an IAR’s social media site that is viewable by the general public does not by itself implicate the testimonial rule.¹⁸
- A third party’s creation and operation of community or fan pages generally would not implicate the testimonial rule, although the Division staff strongly cautions advisers when publishing content from such sites or including hyperlinks or otherwise directing users to them, especially if the sites do not meet the material connection and independence conditions noted above.¹⁹
- The Division staff also abandoned its earlier position that an advertisement containing noninvestment related commentary about an IAR, such as an IAR’s religious affiliation or community service, violates the testimonial rule.²⁰

Conclusion

Although the new guidance permits use of certain social media testimonials that meet the above conditions, advisers are cautioned to carefully review such commentaries to ensure their publication does not violate the other advertising rules (*e.g.*, the Advisers Act rule 206(4)-1(a)(5) (the prohibition on false or misleading statements))²¹ or state law requirements regarding publication of third-party content. Advisers also should consider updating their compliance policies and procedures to include their review process and standards for publishing third-party content.

END NOTES

- 1 DIVISION OF INVESTMENT MANAGEMENT, SECURITIES AND EXCHANGE COMMISSION, NO. 2014-4, IM GUIDANCE UPDATE: GUIDANCE ON THE TESTIMONIAL RULE AND SOCIAL MEDIA (2014) (UPDATE), *available at* <http://www.sec.gov/investment/im-guidance-2014-04.pdf>.
- 2 Advisers Act § 206(4), 15 U.S.C. § 80b-6(4).
- 3 Advisers Act Rule 206(4)-1(a)(1), 17 C.F.R. § 275.206(4)-1(a) (2014).
- 4 UPDATE, *supra* note 1, at 2 (citing Cambiar Investors, Inc., SEC No-Action Letter, 1997 WL 528245 (Aug. 28, 1997)).
- 5 *Id.* at 3, Item A1.
- 6 *See id.* at 2 (citing New York Investors Group, Inc., SEC No-Action Letter, 1982 WL 29455 (Sept. 7, 1982)).
- 7 The Division staff broadly defines “publication” as “any form of real-time broadcast through social media or the Internet whether by hyperlinking, posting, livestreaming, tweeting, or forwarding or any similar public dissemination and, does not relate to advertisements on non-Internet or non-social media sites, such as paper, television or radio.” *Id.* at 1, n.1.
- 8 An “Independent Social Media Site” refers to a “third-party social media site[] that predominantly host[s] user opinions, beliefs, findings or experiences about service providers,” including advisers or IARs. *See id.* at 1, n.2 (providing Angie’s List as an example). The Division staff specifically notes that an adviser’s or an IAR’s own social media account is not an “Independent Social Media Site.” *Id.*
- 9 *Id.* at 3-4, Item A2.
- 10 *Id.* at 4, Items A2-A3.

- 11 *Id.*
- 12 *Id.* at 6, Item A6.
- 13 *Id.* at 5, Item A4.
- 14 *Id.*
- 15 *Id.* at 5, Item A5.
- 16 *Id.*
- 17 *Id.* at 6, Item A7.
- 18 *Id.* at 7, Item A8.
- 19 *Id.* at 7, Item A9.
- 20 *Id.* at 3.
- 21 See Advisers Act Rule 206(4)-1(a)(5), 17 C.F.R. § 275.206(4)-1(a)(5) (2014).