WHITE
PAPER

Social Media in Investment Management

To Tweet or Not to Tweet: It's Not Even a Question Anymore

A Best Practices Framework for Investment Advisors

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Like wannabe hipster grown-ups tantalized but wary about the latest dance craze, many investment advisors are having trouble making up their minds about social media. They'd like to get out there on the floor with the kids, but they are unsure of the steps and understandably nervous about looking foolish or falling on their faces. So far—and with little help and scant guidance from regulators—they've been edging their way out onto the social media dance floor, but with less than the completely unself-conscious spirit the whole phenomenon is supposed to embody.

Social media's potential value to investment advisors is enormous and growing. It provides a remarkably intimate and direct—not to mention inexpensive — way to connect, build trust with, and inform a large number of customers. It also presents a range of regulatory and operational problems. They all center on the tension between the wide-open, sometimes anarchic ethos of the Internet and the need of any financial business to tightly control the flow of information. The aim of this document is to clarify the major pitfalls of social media use for investment managers and to provide some ideas toward development of best practices.

Advisors Dive In—Sort Of

Social media has moved from the fringes of techno geek culture to the mainstream with astonishing speed. The terms "social media" (or "social networking" or "Web 2.0") is a catch-all for a variety of digital services, usually free to users and carrying advertising, perhaps the best known of which is Facebook. The field also includes everything from individual bloggers to Twitter and YouTube, to location-based network FourSquare, Digg, reddit, Flickr, RSS and on and on. A few years ago, this entire industry didn't even exist. Now it's growing and evolving too quickly for anyone to keep pace with it. Where all this is going to end up is impossible to predict, except to say that it is not going away, particularly given the proliferation of smartphones, iPads and tablets, and other mobile devices.

A 2010 survey by Socialware, a firm that makes social media management software for advisors, found that a growing number of managers were using social media and winning new business as a result. In May 2011, Morgan Stanley Smith Barney, a Socialware customer, announced that it would be permitting its 18,000 advisors to use Twitter and LinkedIn soon and planned eventually to add Facebook. Andy Saperstein, head of wealth management for the firm, told the Financial Times, "Many of our clients have been demanding social media. Many of our advisers have been demanding it." But if Morgan Stanley's move indicates firms' growing acceptance of social media, it also revealed their trepidation: all posts, "tweets" and IMs by Smith Barney advisors will have to be done using templates pre-approved by the firm. The reason is to make sure everything that Smith Barney advisors say online is consistent with firm policies and regulations.

According to a survey by Aite Group, a financial services research and consulting firm, many investment managers bar their employees from using social media in connection with their work altogether. And while a number of large firms, among them Raymond James Financial and Commonwealth Financial Network, have taken the social media plunge at least to a limited degree, hiring companies that provide social media monitoring and record-keeping services, smaller players have been more hesitant. As Doug Flynn, an advisor at Flynn Zito Capital Management, which has $275 million in assets under management, recently told Investment News, " I'd love to start tweeting to the general public once they can clearly tell me what I can and can't do. However, putting yourself out there too much without specific guidelines is just not worth the risk."

Confused? So Are the Regulators

Technology has always outpaced regulation, and social media is no exception. Regulators in the US and Europe have so far issued only general regulatory guidance and still seem to be struggling to get their arms around the issue. In late 2010, the US Securities Exchange Commission (SEC) sent a "sweep letter" to registered investment advisors asking for documentation of their use of social media. The move caused some anxiety through the industry, but seemed to indicate the SEC was still in information-gathering rather than enforcement mode. In May 2011, Massachusetts secretary of state William Galvin, who regulates the securities industry in his state, sent out a similar request. Clearly momentum is gathering for some sort of comprehensive compliance guideline.

The SEC's last major statement on the subject came in 2008 when it released broad regulatory guidance on use of the Internet—though not specifically on social media—for financial advisors. In essence, the SEC said all forms of digital media were—just like written communications, phone calls, and email before them—subject to relevant federal anti-fraud law, in particular the Investment Advisers Act of 1940. That meant firms would have to implement policies to prevent misleading or deceptive posts and would have to keep records of an employee's social media activity. Beyond that, however, the SEC provided few specifics.

Across the Atlantic, the UK's Financial Services Authority (FSA) has issued similarly vague directives. Last year it released a brief summary of a review of Facebook and Twitter use by financial services companies, reiterating that previous rules about written communications apply to digital media and noting that some sites it reviewed lacked required risk disclosure information.

Somewhat more detailed guidance has come from the Financial Industry Regulatory Authority (FINRA), which last year issued guidelines on social media for broker-dealers (FINRA Regulatory Notice 10-06; and a "Guide to the Internet for Registered Representatives" available at www.finra.org). Like other regulators, FINRA emphasized that social media communications were subject to the same restrictions concerning advertising, suitability and so forth that cover in-person or telephone contacts between advisors and clients.

Going a step further, FINRA attempted to divide social media use into two broad categories. "Static" communications—say, firm profiles—are considered advertisements and as such must be approved in advance by a registered principal of the firm. "Interactive" communications—emails, chat room exchanges, instant messages, status updates or comments on a blog—are considered "appearances" and don't need advance approval. But they must follow FINRA's communication rules: they must be made in good faith, not be misleading, not project future performance, and so forth. They also must be recorded and retained, although FINRA has been vague so far about how long records must be kept.

To the extent that social media is just a new forum for saying things—like newspapers, radio and television before it—it presents few new compliance issues. A broker recently ran afoul of the SEC for front-running his clients using Twitter. The swindle is as old as stocks themselves and would have landed the broker in trouble had he used smoke signals or semaphore flags. The thing that makes social media different is the ease with which existing material can be copied or recycled: a YouTube video may be easily reposted to a Facebook page, a blog entry may be tweeted and retweeted ad infinitum. A key problem for investment managers trying to stay compliant is figuring out when and if they are responsible for non-original content that their advisors may post, repost, or link to.

The Four Main Social Media Channels

A quick look at the main channels of social media will illustrate some of the main compliance issues managers face. Malicious or misleading posts on social media are obvious sources of trouble, as is disclosure—accidental or not—of insider information or trade secrets. More challenging, however, are problems that may arise from innocent but careless use of social media.

Facebook: Friends Don't Let Friends Post Recklessly

Facebook was launched in 2004 and now boasts more than 500 million active users around the world. According to the company, 50 percent of users log on to Facebook in any given day, the average user has 130 friends, and more than 250 million users access Facebook via mobile devices. Facebook's phenomenal growth has made its founders the subject of hit movie and enriched them beyond even the wildest dreams of wealth. It has also been plausibly credited with significant political and social clout, such as helping spread democratic upheaval across the Arab world. And in what was widely viewed as an acknowledgment of Facebook's success, Google recently launched a competing service called Google Plus, which seems to be getting traction in the already-crowded social media space.

Initially largely limited to individual users, Facebook has since proven hugely attractive to businesses as well—especially B2C businesses, under which rubric financial planning services and investment management might plausibly be grouped. In fact, a Facebook search on "investment management" will turn up hundreds of firms that have already staked their claim on the site. The service is modeled after the "face books" provided at many schools and universities, listing students' names, photos, interests, fields of study and the like. Briefly, on a Facebook page, a person (or organization) posts material—words, images, links, etc.—which remains static until the user changes it. In addition, a user's page gets constantly updated public postings from the pages of their "friends." Users become "friends" by mutual agreement and one's list of friends can be as large or small as desired. Friends who fall out or lose interest can end their connection via "unfriending." Facebook also provides email and instant messaging between "friends."

The biggest potential compliance problem for advisors using Facebook is "liking." Users can signal their approval of posts, links, or comments posted by others by clicking a button, which places a "thumbs-up" icon next to the item in question. For someone using Facebook in their personal life, this is usually a highly casual matter of signaling approval of a cute baby picture or saying "Yeah, I agree" to a comment posted by a friend. For an advisor, however, this seemingly innocent action could have potentially serious consequences. For a representative of an advisor to "like" something on Facebook—say a link to financial commentary, an economic forecast, or a discussion of a company—constitutes, according to FINRA's Regulatory Notice 10-06, an endorsement which means the advisor adopts whatever is being said as his or her own. And by extension this action could even be considered an endorsement by the firm that employs the advisor. If the material liked doesn't pass regulatory muster, the advisor and the firm could have problems. For instance, if a representative were to "like" a friend's status update in which a company or investment is mentioned that action could be considered an recommendation under NASD rule 2310, which requires members to take pains to make sure recommendations are "suitable" to specific customers. Because of the risk inherent in "liking," some compliance consultants have recommended either using software to block the function or banning Facebook use entirely.

Another potential compliance problem comes from the huge and growing number of add-ons—from games like Farmville to business applications—made for Facebook. A firm permitting representatives to use Facebook for work will either have to review any application used by an employee for SEC/FINRA compliance or block the use of all add-ons

Twitter: To Tweet or Not to Tweet?

Founded in 2006, Twitter is a micro-blogging service that claims over 200 million users around the world. Registered users get personal web pages on which they may post items—either their own thoughts or links to other web pages—of no more than 140 characters each. Users can post as many of these "tweets" as they like. They may also sign up to receive the tweets of other users they wish to follow, and they can comment on others' tweets" or re-tweet them to their own followers. Due to the limitation on the length of posts, Twitter is often considered a mobile service, with users posting from smartphones or other mobile devices, although you can also post from your desktop PC.

The Twitter concept at first seemed so limited that it was hard to believe there was an audience for it—much less a business case to be made for it—but today Twitter users around the world send some 200 million tweets a day. It has become sufficiently mainstream that it has moved beyond the realm of publicity-hungry Hollywood stars and headline-grabbing politicos to become yet another marketing arrow in the quiver of legitimate companies and organizations.

Predictably, Twitter's popularity has spawned a host of similar competing services, including Yammer, Salesforce's Chatter, Google Buzz, Qaiku, Jaiku, bentio.com and many more. While individual companies are subject to the vicissitudes of the market and may come and go like other Internet start-ups, the phenomenon of micro-blogging is clearly here to stay, raising questions for advisors and firms considering using this new communication tool.

Tweeting poses many of the same potential pitfalls as Facebook posts. FINRA says that tweeting or retweeting constitutes an endorsement and could constitute noncompliance with its rules if the content is false, misleading, or otherwise inappropriate for an advisor. As with Facebook, Twitter users can "like" items that other people have posted. If an advisor were to "like" a tweet by a friend saying "XYZ is a great company" the SEC might consider that action to be an investment recommendation made without due consideration of whether it was suitable to any of clients or others who might be reading. Hence, it's generally considered prudent to tread carefully through the Twitter landscape and to think twice about what you're tweeting or retweeting.

LinkedIn: Social Networking Goes Pro

LinkedIn may be the most advisor friendly of the major social networking services. According to Socialware, 57 percent of advisors who say they use social networking for business use LinkedIn. As of March 2011, LinkedIn had more than 100 million registered users around the world, putting it far ahead of its nearest comparable competitors.

Launched in 2003, LinkedIn is a business and professional networking service used primarily by jobseekers and recruiters. Users can post their employment histories, resumes and links to examples of their work. Like Facebook, they can also link by mutual agreement to the pages of other users, thus widening their circle of potential contacts. Users may also post recommendations for other users, connect via an email service, and share Twitter posts.

Perhaps because of its more clearly professional (as opposed to personal or entertainment) focus, LinkedIn appears less likely to attract mischievous or careless posting by advisors than other social networking channels. Nevertheless, prudence and good judgment must be employed when using the service in a professional capacity.

As with other social media, it is the question of endorsing things or people that presents the most potential compliance danger. According to FINRA, a recommendation of someone on LinkedIn constitutes is "static" content and therefore an advertisement. As an ad it is subject to Rule 206 (4)-1 of the Investment Advisors Act of 1940, which bars testimonials—and what is a recommendation if not a testimonial? If an advisor were to recommend, say, his brother-in-law as an "expert stock picker with a stellar track record," FINRA and other regulators could be expected to take a dim view of the matter. Here again, consider the ramifications of a post on LinkedIn before making it and err on the side of caution if you're unsure whether it could cross a regulatory line. It's also wise to clearly identify comments as your personal opinions, rather than those of your employer.

Blogs: Express Yourself via D-I-Y Journalism

A "blog"—a neologism formed by blending the term "web log"—is simply a web page maintained by an individual or organization that is periodically updated with new information, links, diary entries, video clips or the like. Blog posts, which are typically displayed in reverse chronological order, may range from highly professional to very informal to completely scurrilous. Blog visitors can usually leave comments or messages as well, and it's this interactive dialogue capability that sets blogs apart from static websites.

Blogging grew out of early limited digital communities like Usenet, Genie, CompuServe, bulletin board systems and other networks in the 1980s and 1990s. The first bloggers were diarists who documented their lives and ideas for a small audience of cyber-enthusiasts. As the Internet grew larger and more accessible, the tools for blogging became ubiquitous. Now the "blogosphere" is enormous, consisting of everything from diarists much like the pioneer bloggers to celebrity news sites like TMZ to influential political commentators to WikiLeaks, to policy statements from the World Bank.

Blogging has experienced exponential growth lately, following the typical trajectory from individual users to groups and companies, and the Nielsen Company estimated that there were more than 150 million public blogs in existence as of February 2011. Today a growing number of investment advisors have taken up blogging too—posting their thoughts and opinions on the economy, markets, investing trends—as well as commenting on other blog posts. FINRA regards blogs as static content—that is to say advertisements, and subject to the SEC restrictions like those on testimonials and claims of future performance.

Blogs and similar channels like discussion forums and online chat rooms have proven a dangerous temptation to some CEOs who were inclined to diss their competitors or hype their own shares. For example, between 1999 and 2006 Whole Food Market CEO John Mackey used the screen name "rahodeb" (an anagram of his wife's first name) to post over 1,000 entries talking up his company's prospects and trashing those of rival Wild Oats on an Yahoo financial discussion board. Using this pseudonym, Mackey predicted the competitor would go bankrupt to drive down its stock price and then bought Wild Oats stock at prices as low as $5 a share. Shortly thereafter, in February 2007, Whole Foods announced that it would buy Wild Oats for $18.50 a share. The SEC investigated Mackey's posts but took no action against him, and he eventually posted a long and tendentious defense of his actions on his own blog, thereby closing the blogging circle.

Best Practices: A Framework for a Comprehensive Social Media Policy

Although the regulatory picture is still somewhat vague and evolving, there is a fair degree of consensus around best practices for social media. The main goals for advisors are to integrate social media into a coherent overall risk management strategy, avoid problems with the SEC and FINRA, and reassure investors that their best interests come first. A few general rules:

1. The first rule is simply common sense: anything said, posted or shared via social media should be assumed to be governed by existing rules for written, electronic or in-person communication. In other words, if an advisor wouldn't say it face-to-face to a client, they shouldn't tweet it.
2. Firms should have their own,written social media policy consistent with their own procedures and values. An off-the-shelf, "canned" document won't pass muster. Employees permitted to use social media in their work should be trained in it and sensitized to concerns and potential problem areas.
3. A chief compliance officer should be named to monitor compliance. That means being responsible for keeping the firm up to date on all regulations and reviewing "static" material for compliance before it is posted online and periodically reviewing "interactive" material after it has been posted. It also means archiving in an easily discoverable form everything that goes online.
4. Only employees specifically authorized to use social media should be allowed to do so. Some firms have also put some restrictions on advisors personal use of social media during off-hours, prohibiting from them from discussing company business or posting company logos and asking them to ad disclaimers on personal blogs. If a firm is not able to monitor a particular social media channel, employees should not be allowed to use it in their work.
5. Keep records of all firm social media activity. While it is so far unclear how long such records will have to be kept, regulators have been asking investment advisors for them. There is no reason to think that records of social media activity should not become discoverable evidence (just like IMs, emails, and telephone records) in administrative or legal proceedings.
6. Leverage technology to ensure compliance. A number of companies now offer software platforms designed to monitor, archive, and filter social networking communications in accordance with a firm's policy and federal regulations. Some companies in this space include Socialware, FaceTime Communications, and Arkovi.

Additionally, linkedFA, a social networking service launched last year (despite the name it is not affiliated with LinkedIn), is aimed directly at financial advisors and offers archiving service as well as compliant email templates for client communications.

Be Careful What You "Like"

Using social media effectively—and compliantly—requires a substantial investment of time, energy, and resources. It's a real commitment to establish and maintain the sort of instantaneous, two-way dialogue that social media channels foster. If advisors regard social media as a passing gimmick—blogging, for instance, once a month and then forgetting about it—they are unlikely to engage clients or prospects. They are also more likely to run the risk of running afoul of regulators with careless postings. Firms unwilling to accept the public give-and-take inherent in social media probably ought to avoid it altogether.

In general, good sense and responsible business practices should give advisors sufficient guidance in most areas of social media. Firms, however, should tread very carefully around the subject of "liking" (on Facebook and Twitter) and "recommending" (on LinkedIn). These things are easy to do casually, but may cause inadvertent regulatory breaches. Forbidding these functions or blocking them with software may give managers peace of mind without significantly inhibiting the firm's use of social media.

The key idea for firms willing to take the plunge into social media is, as with all their other client-facing communications, control. Ethical, responsible firms that have good control over how their people use social media—that is to say, firms with sensible, well enforced, and well explained policies—should have nothing to fear from the use of these new technologies. And as regulation inevitably catches up with technological advances, clearly defined best practices and rules of the road will become codified to guide investment advisors and their firms in the use of social media.

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