CARLTON FIELDS

FINRA and SEC Float Concerns Over Social Media Finfluencers

Expect Focus
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Social media marketing is an important form of advertising in our digital world, particularly with a target audience of younger investors. This has caught the eye of FINRA and the SEC.

Social media influencers in the financial services industry (informally dubbed "finfluencers") receive compensation from broker-dealers, investment advisers, or others to promote financial products on social media platforms such as TikTok, Facebook, Instagram, YouTube, X, Stocktwits, Reddit, and Twitch. Through a variety of social media influencer programs (or referral programs), finfluencers with large online followings may receive bonuses, rewards, incentives, or other compensation for referring new customers to open accounts at a firm or purchase securities from a firm.

FINRA Finfluencer Sweep. To gain a better understanding of firm practices related to the acquisition of customers through social media, FINRA conducted a targeted examination (finfluencer sweep), commencing in September 2021.

FINRA sought information on how firms manage their regulatory obligations, including those related to information collected from customers acquired through social media. In addition to reasonable broker-dealer supervision of social media influencers and review and retention of social media influencer communications, FINRA is concerned about associated privacy issues such as the collection of browser cookies obtained from customers or individuals who provide nonpublic information but are not onboarded as customers.

FINRA's finfluencer sweep sought 10 items of information relating to social media influencers, referral programs, and related general information, and 10 items of information relating to compliance with SEC Regulation S-P governing the privacy of consumer financial information, such as written supervisory procedures, privacy notices, and
opt-out notices.

In February 2023, FINRA provided an update on the finfluencer sweep. FINRA organized its review in two parts: first, firms' use of social media influencer and referral programs to promote their products and services and recruit new customers; and second, firms' privacy notices (and options to opt out) regarding the collection and sharing of their usage information. The update identified firm practices to assist firms in evaluating their social media influencer and referral programs, including whether their practices and supervisory systems are reasonably designed to address relevant risks. The update also stressed compliance with Regulation S-P obligations and other regulations for protecting customer nonpublic information with non-affiliated third parties.

FINRA Enforcement Actions. Thus far in 2024, FINRA has settled three finfluencer-related enforcement actions (on March 15, April 3, and June 10). Each action censures and fines a firm for alleged violations of FINRA Rules 2210 and 2010. FINRA alleges in each action that social media influencer posts were not fair or balanced, or were inappropriately exaggerated or promissory. FINRA also alleges that each firm did not review or approve the content of influencer posts, retain influencer communications, or have a reasonable system in place for supervising influencer communications. The June 10 action also alleges violations of Regulation S-P relating to inaccurate privacy notices and sharing nonpublic information (including customer names, email addresses, Social Security numbers, birthdates, and state IDs) with non-affiliated third parties for marketing purposes.

SEC Enforcement and Guidance. For its part, on February 16, 2024, the SEC announced a settled action against a registered investment adviser for not disclosing a social media influencer's role in the launch of a new exchange-traded fund. The SEC's complaint alleges that the influencer's involvement, and details of an anticipated licensing arrangement, were not disclosed to the independent trustees of the trust in connection with their approval of the management fee. The complaint alleges violations of Section 15(c) of the Investment Company Act of 1940 and Sections 206(2) and 206(4) of the Investment Advisers Act of 1940. Without admitting or denying the violations, the investment adviser agreed to a censure and fine of $1.75 million.

The SEC is concerned that some social media influencers may be full of hot air. To address this concern, the regulator has issued investor alerts addressing risks associated with social media and investing. Among them, the SEC warned college students that they "should exercise caution before following any investment advice from a social media source" and "not be swayed by testimonials or celebrity endorsements when making an investment decision."

As to the outlook from here, although the use of finfluencers may not be under a dark regulatory cloud, persistent fluffy white ones, at least, are definitely in the forecast.

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