

Influencer Considerations as FINRA Initiates Crackdown

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Published in [Law360](#) on May 22, 2024. © Copyright 2024, Portfolio Media, Inc., publisher of Law360. Reprinted here with permission.

In September 2021, the Financial Industry Regulatory Authority initiated a targeted exam of firm practices for acquiring customers through social media platforms.^[1]

This social media sweep focused on two key issues: (1) firms' use of social media influencers and referral programs to promote their products and services and recruit new customers, and (2) firms' privacy notices regarding the collection and sharing of their usage information.

As with other targeted exams, FINRA has gathered information through the sweep to focus examinations and carry out investigations on selected firms.

In February 2023, FINRA published an update on the sweep, which offered select practices — observed by the FINRA exam staff during the sweep — that firms should consider when evaluating their own use of social media influencer and referral programs.^[2] This guidance is summarized below:

Written Supervisory Procedures: Update WSPs to focus on social media influencer and referral programs — considering additional controls for influencers with a large social media presence, as well as additional requirements for programs managed by member firms, affiliates or marketing agencies.

Background Checks: Evaluate potential social media influencers' backgrounds and prior public social media activities for compliance and reputational risks before admitting them into their social media influencer programs.

Training: Provide training, and define permitted and prohibited conduct for social media influencers.

Recordkeeping: Maintain records of social media influencer and referral program communications with the public consistent with applicable regulatory recordkeeping obligations.

Risk and Compliance: Address social media influencer- and referral program-related compliance, and reputational risks and concerns.

M1 Finance LLC Settlement

Following its publication of guidance concerning social media practices, in March, FINRA's enforcement division announced its first-ever settlement involving a firm's supervision of social media influencers.^[3]

The respondent, M1 Finance LLC, is a financial technology company that provides self-directed trading to retail investors through its mobile application and website.

In connection with FINRA's targeted exam of M1's use of social media influencers to acquire new customers, FINRA found that social media posts made by influencers on the firm's behalf were not fair or balanced, or contained exaggerated, unwarranted, promissory or misleading claims.

According to FINRA, M1 also failed to establish, maintain and enforce a reasonably designed supervisory system for its influencers' social media posts, and failed to preapprove and preserve records of these retail communications.

As FINRA previously stated in Regulatory Notices 10-06^[4] and 17-18,^[5] social media posts will be considered retail communications for the purpose of Rule 2210 if the member firm either (1) paid for or was involved in the preparation of the content prior to posting, or (2) explicitly or implicitly endorsed or approved the content.

According to FINRA, between January 2020 and April 2023, M1 recruited and paid approximately 1,700 social media influencers over \$2.75 million for generating leads.

This action resulted in more than 39,400 new accounts for the firm. M1 provided the influencers with graphics and guides highlighting M1's specific products and services, which the influencers could use to make their posts more effective.

A welcome guide provided by the firm to the influencers advertised the firm's lack of commissions or management fees and its margin lending program.

Each influencer was also assigned a unique hyperlink to include in their social media posts, which directed potential customers to a page on the firm's website where they could open and fund an M1 brokerage account.

M1 paid each influencer a flat fee for every new account opened and funded through their assigned hyperlink.

This compensation structure may have unintentionally incentivized the kind of puffery that — while commonplace on social media — violates the content standards governing FINRA members' communications with the public.

By way of example, M1 influencers posted videos promising positive returns — e.g., stating, "it is a general principle that anyone who starts a ROTH IRA ... in their 20s will become a millionaire by the time they're 60" — without a balanced discussion of the risks associated with investing.

M1 influencers also misled customers about specific products, such as M1's margin lending program. In a video posted to social media, one influencer advertised the firm's lending program by stating that customers "can pay

[margin loans] back at any given time ... there is no set time period,” failing to mention the significant impact of the firm’s maintenance margin requirements and fluctuating interest rates.

Other posts stated that M1’s services were completely free — i.e., “with M1 Finance, you can trade for free ... [and] every dollar you are putting into the platform is actually going into that ETF or that stock or bond” — while failing to disclose that certain fees may apply or to provide a link to the firm’s fee schedule.

Consequently, FINRA found that M1’s influencer communications about the firm were unfair and unbalanced, or made claims that were exaggerated, unwarranted, promissory or misleading, violating FINRA Rules 2210(d)(1) and 2010.

Additionally, because the influencers’ posts qualified as retail communications under FINRA Rule 2210(b)(1)(A), an appropriately registered principal of the firm was required to review and approve each post before use, which M1 failed to do.

The firm also failed to maintain records of the influencers’ posts as required under Exchange Act Rule 17a-4(b)(4) and FINRA Rules 2210(b)(4)(A) and 4511, and failed to establish, maintain, and enforce written supervisory procedures or systems designed to supervise social media posts disseminated on the firm’s behalf in violation of FINRA Rules 3110 and 2010.

Without admitting or denying FINRA’s charges, M1 agreed to pay an \$850,000 fine and implement a supervisory system for its influencers. The firm revised its policies and procedures to require that a registered principal of the firm review and approve influencer posts prior to use.

The firm also implemented a system to retain social media communications disseminated by influencers on the firm’s behalf. In the press release announcing the M1 settlement, Bill St. Louis, FINRA’s head of enforcement, cautioned that “FINRA will continue to consider whether firms are using practices and maintaining supervisory systems that are reasonably designed to address the risks related to social media influencer programs.”

In his remarks at a recent Securities Industry and Financial Markets Association conference, St. Louis emphasized the importance of social media supervision by member firms that engage in it, and indicated there are more cases involving the use of social media influencers by fintech companies on the enforcement docket.

Cobra Settlement

Keeping his word, in April, FINRA’s Enforcement Division took receipt of a letter of acceptance, waiver and consent on behalf of Cobra Trading Inc. stemming from the firm’s influencer activity, in a settlement nearly identical to that with M1 Finance.^[6]

Cobra, a Texas-based firm providing self-directed trading to retail investors through its online portal, became a FINRA member in 2004. Between November 2019 and October 2023, Cobra paid 17 influencers for promotional communications on their social media platforms.

The firm provided the influencers with selling points highlighting specific services for them to use in their social

media communications, as well as unique links directing followers to a page on the firm's website to open and fund a Cobra brokerage account.

As in the M1 case, according to FINRA, Cobra paid these influencers a flat fee for every new account opened and funded by a customer using the influencer's unique link. Between 2019 and 2023, Cobra Trading's influencer program generated 775 new accounts, each funded with at least \$25,000.

Mirroring the M1 enforcement action, FINRA found Cobra's influencer communications about the firm constituted retail communications, and were unfair and unbalanced, or made claims that were promissory, violating FINRA Rules 2210(d)(1) and 2010.

For example, one influencer promoted the firm by telling his followers, "I took a \$30K account and turned it into \$133K in less than 30 days w/a Cobra Account," failing to include a balanced discussion of the risks involved in investing and improperly suggesting his followers could achieve similar results.

According to FINRA, Cobra further failed to properly review or retain the influencers' posts prior to posting and failed to establish or maintain a system of written supervisory procedures in violation of Section 17(a) of the Securities Exchange Act; Exchange Act Rule 17a-4(b)(4); and FINRA Rules 2210(b), 4511, 3110 and 2010.

Without admitting or denying FINRA's findings, Cobra Trading agreed to pay a \$200,000 fine and implement a supervisory system for its influencers.

The firm also revised its policies and procedures governing the review, approval, and retention of influencers' communications with the public.

Future Regulatory Enforcement in Social Media Influencing

Influencer social media communications on a firm's behalf have a high potential to violate FINRA's rules governing unbalanced and misleading claims if not properly regulated.

Accordingly, a firm's proper supervision and recordkeeping of such communications are crucial to ensuring its social media practices are reasonably designed to address risks related to social media influencer and referral programs.

FINRA's efforts to crack down on member firms' social media strategies come at a time when an increasing population of individuals is receiving information, including personal finance information, from social media influencers.

In the era of social media, FINRA recognizes that it must broaden its supervision of firm activities on these platforms to better protect the public.

FINRA is not the first regulator to leverage its enforcement authority to address the impact of social media influencers. The Federal Trade Commission has long combatted the spread of misinformation through social media influencers.

Among other things, the FTC monitors sponsored social media activity, provides educational materials for social media influencers, and brings charges against companies and influencers who mislead the public.

The FTC's activity in this space tends to focus on two issues: (1) whether influencers have sufficiently disclosed that they are being paid to promote a product, and (2) whether their social media posts contain false or misleading statements about the product's efficacy.

As the power and prevalence of social media influencers continue to grow, we can expect the scope of regulatory enforcement action in this space to expand along with it.

For their part, FINRA and the FTC are prioritizing efforts to inform companies of the necessary compliance when gaining customer attention via social media.

[1] <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/social-media-influencers-customer-acquisition-related-information-protection>.

[2] <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/sweep-update-feb2023>.

[3] <https://www.finra.org/media-center/newsreleases/2024/finra-fines-m1-finance-850000-violations-regarding-use-social-media>.

[4] <https://www.finra.org/rules-guidance/notices/10-06>.

[5] <https://www.finra.org/rules-guidance/notices/17-18>.

[6] https://www.finra.org/sites/default/files/fda_documents/2021072501001%20Cobra%20Trading%2C%20Inc.%20CRD%20132078%20AWC%20gg%20%282024-1714782000987%29.pdf.

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