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THE 2024 TOUR: SEC AND FINRA REGULATORY DEVELOPMENTS RELATING TO RILA ADVERTISING, ARTIFICIAL INTELLIGENCE, FINFLUENCERS, AND RESIDENTIAL NON-BRANCH LOCATIONS

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"Rather than attempting to adopt a sweeping new rule to deal once and for all with AI, we may be better off approaching it in a manner similar to how we treated the internet last century. If regulated firms need guidance on how particular AI practices interact with the securities regulatory framework, we should listen carefully without prejudice or hostility and provide timely, meaningful feedback rooted in law."

SEC Commissioner Hester M. Peirce, *Pourquoi Pas? Securities Regulation and the American Dream: Remarks before the Association of Private Enterprise Education,* April 8, 2024.

[1] The author dedicates this paper to her former colleague, Gary O. Cohen, who sadly passed away on August 27, 2024. Over the years, the author received helpful commentary on her papers from Gary Cohen; this paper regrettably lacks his input. The author thanks Richard Choi and Thomas Lauerman of Carlton Fields, P.A., for their valuable contributions to this paper. The author's views do not necessarily reflect the views of her law firm, the law firm's individual shareholders and other lawyers, or any of the law firm's clients.

CARLTON FIELDS

TABLE OF CONTENTS

Page

I. INTRODUCTION AND OVERVIEW

In addition to the Paris Olympics and U.S. presidential election, the year 2024 brought new rules pertaining to advertising of registered index-linked annuities ("RILAs") and guidance from securities regulators on artificial intelligence ("AI") and financial social media influencers ("finfluencers").

This paper outlines recent Securities Exchange Commission ("SEC") action relating advertising RILA products. Commenters on the RILA rule package had urged the SEC to amend Rule 482 under the Securities Act of 1933 ("Securities Act") to cover RILAs. However, the SEC did not do so in the final RILA rule amendments that it adopted on July 1, 2024. Instead, the SEC left an unlevel advertising playing field among RILA issuers and between RILA issuers and variable annuity issuers, though it did invite further consideration of the issues.

The paper also outlines recent Financial Industry Regulatory Authority ("FINRA") developments relating to AI, finfluencers, and non-branch residential supervisory locations ("RSLs"), non-RSLs, and FINRA's remote inspection pilot program.

II. RILA ADVERTISING ISSUES

A. Background

1. **RILA Act**. At year-end 2022, Congress adopted legislation requiring the SEC to develop a new registration form for RILAs by June 30, 2024, or permit life insurance companies to register RILAs on Form N-4, the registration form for variable annuities. A RILA is an annuity that is registered with the SEC, issued by a life insurance company, not issued by an investment company, and the returns of which "(i) are based on the performance of a specified benchmark index or rate (or a registered exchange traded fund that seeks to track the performance of a specified benchmark index or rate); and (ii) may be subject to a market value adjustment if amounts are withdrawn before the end of the period during which that market value adjustment applies." *Registration for Index-Linked Annuities Act*, S.3198, 117th Congress, incorporated into H.R. 2617, Consolidated Appropriations Act, 2023, and signed by President Biden on December 29, 2022 (hereinafter "RILA Act").

2. **Permissible Forms of RILA Advertising.** As discussed below, the SEC's RILA rule package maintained the current situation regarding permissible forms of RILA advertisements. RILA issuers and distributors are permitted to use (a) supplemental sales literature if accompanied or preceded by a prospectus and (b) Rule 134 "tombstone" ads with content limited to specified categories. Seasoned issuers and well-known seasoned issuers ("WKSIs") that file periodic reports pursuant to Section 15(d) of the

Securities Exchange Act of 1934 ("Exchange Act") may use "free writing" prospectuses without accompanying or preceding the free writing prospectus by a full "statutory" prospectus.

a) **Supplemental Sales Literature**. Section 2(a)(10) of the Securities Act defines the term "prospectus" to include any "prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security." Paragraph (a) of Section (2)(a)(10) sets forth an exception from the definition of prospectus for "**a communication sent or given after the effective date** of the registration statement (other than a prospectus permitted under subsection 10(b) of this title) shall not be deemed a prospectus if it is proved that **prior to or at the same time with such communication a written prospectus** meeting the requirements of subsection 10(a) of this title at the time of such communication **was sent or given** to the person to whom the communication was made." (Emphasis added.)

b) **Rule 134 Ads**. Rule 134 sets forth items of information that may be contained in a 134 tombstone ad without the communication being deemed a prospectus. A 134 ad may include the following types of information:

(1) Factual information about the legal identity and business location of the issuer limited to the following: the name of the issuer of the security, the address, phone number, and e-mail address of the issuer's principal offices and contact for investors, the issuer's country of organization, and the geographic areas in which it conducts business;

(2) The title of the security or securities;

. . .

(8) The name, address, phone number, and e-mail address of the sender of the communication and the fact that it is participating, or expects to participate, in the distribution of the security;

(9) The type of underwriting, if then included in the disclosure in the prospectus that is part of the filed registration statement;

(10) The names of underwriters participating in the offering of the securities, and their additional roles, if any, within the underwriting syndicate;

. . .

(12) A description of the procedures by which the underwriters will conduct the offering and the procedures for transactions in connection with the offering with the issuer or an underwriter or participating dealer (including procedures regarding account opening and submitting indications of interest and conditional offers to buy), and procedures regarding directed share plans and other participation in offerings by officers, directors, and employees of the issuer;

(13) Whether, in the opinion of counsel, the security is a legal investment for savings banks, fiduciaries, insurance companies, or similar investors under the laws of any State or Territory or the District of Columbia, and the permissibility or status of the investment under [ERISA];

(14) Whether, in the opinion of counsel, the security is exempt from specified taxes, or the extent to which the issuer has agreed to pay any tax with respect to the security or measured by the income therefrom;

. . .

(16) Any statement or legend required by any state law or administrative authority;

. . . and

(22) Information disclosed in order to correct inaccuracies previously contained in a communication permissibly made pursuant to this section.

c) **Free Writing Prospectus**. Rule 405 under the Securities Act defines, in part, a free writing prospectus as any written communication that constitutes an offer to sell, or a solicitation of an offer to buy, the securities to a registration statement, and is made by means other than a red herring prospectus, a final prospectus, or a written communication that is preceded or accompanied by the final prospectus (that is, supplemental sales literature). Except for issuers that are "ineligible issuers," all other non-investment company issuers may utilize free writing prospectuses under Rule 433. As discussed below, the SEC amended Rule 433 to include RILA offerings that are registered on Form N-4 by issuers who file periodic reports pursuant to Section 15(d) of the Exchange Act.

B. RILA Form Proposing Release and Comments Thereon

1. **Proposal.** In response to the RILA Act, the SEC issued a release on September 29, 2023, that proposed amendments to Form N-4 to make that form available and suitable for registration of RILAs under the Securities Act. *SEC Proposed Rule, Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities*, Securities Act Release No. 11250; Exchange Act Release No. 98624; Investment Company Act Release No. 35028 (Sept. 29, 2023), *available at* https://www.sec.gov/files/rules/proposed/2023/33-11250.pdf [hereinafter the "RILA Form Proposing Release."]

2. **Comments on RILA Form Proposing Release**. Even though the RILA Form Proposing Release treats RILAs as variable annuities for registration statement and financial statement purposes, the SEC declined to treat RILAs as variable annuities for advertising purposes. Commenters on the proposed RILA rule package urged the SEC to allow RILAs to rely on Rule 482 under the Securities Act to level the playing field between variable annuity and RILA advertisements.[2]

3. **Rule 482**. Rule 482 applies to investment company advertisements and allows an ad to include performance information computed in accordance with standardized formulas ("standardized performance"), as well as performance information that is *not* computed in accordance with standardized formulas ("non-standardized performance") provided that such non-standardized performance is accompanied by standardized performance. A Rule 482 ad is an "omitting prospectus," and the Rule does not require that the communication be accompanied or preceded by a statutory prospectus. Rule 482 permits variable annuity issuers to deliver sales material directing the recipient to contact a specified number to receive a prospectus. This is particularly important for ads in the form of billboards, TV commercials, electronic communications, and social media.

4. **Rule 433**. Rule 433 under the Securities Act addresses conditions for using a free writing prospectus and permits seasoned issuers and WKSIs to use a free writing prospectus without preceding or accompanying it by a prospectus. On the other hand, free writing prospectuses used by non-

[2] *See, e.g.,* Insured Retirement Institute (letter from J. Berkowitz and E. Micale dated Nov. 28, 2023) ("The SEC declined to extend Rule 482 to RILAs. We urge the SEC to reconsider this posture and revise the Proposal to bring RILAs under Rule 482, or alternatively, under Rule 433."); Group 1001 (letter from R. Cloud and M. Bloom dated Nov. 28, 2023) ("we believe that Rule 482 … should be modified to apply to RILAs."); Committee of Annuity Insurers (letter from Eversheds Sutherland dated Nov. 28, 2023) ("the SEC should amend Rule 482 to permit RILA advertising under that rule."); and American Council of Life Insurers (letter from J. McAdam dated Nov. 28, 2023) ("By not extending Rule 482 to RILAs, the SEC perpetuates an inconsistency between variable annuities and RILAs as it relates to advertising requirements. In particular, the failure to amend Rule 482 to apply to RILAs necessitates the delivery of a RILA prospectus with all advertisements.").

seasoned issuers must be preceded or accompanied by a statutory prospectus, placing non-seasoned (nonpublic reporting company) RILA issuers at a disadvantage relative to seasoned (public reporting company) RILA issuers that are entitled to rely on more flexible prospectus delivery requirements under Rule 433(b)(1) for free writing prospectuses.

5. **Rule 156**. The SEC adopted Rule 156 under the Securities Act to provide general guidance to investment companies, including variable contract issuers, on what might constitute materially misleading ads. Prior to the RILA rule amendments, the preamble to Rule 156 noted that the federal securities laws prohibit the use of materially misleading sales literature in connection with the offer or sale of securities issued by an investment company. The Rule broadly defined "sales literature" to include "any communication (whether in writing, by radio, or by television) used by any person to offer to sell or induce the sale of securities of any investment company." Rule 156 provides that an ad is materially misleading if it (i) contains any untrue statement of a material fact, or (ii) omits a material fact necessary to make any other statement contained in the communication, considering the entire context of the communication, not misleading. In the RILA Form Proposing Release, the SEC proposed subjecting RILA ads to Rule 156. Rule 156 further explains various circumstances in which an ad may be materially misleading.

C. RILA Form Adopting Release

1. **Final Rules**. The SEC adopted the new RILA registration form and related rules on July 1, 2024. *Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities*, Securities Act Release No. 11294 (July 1, 2024) [89 Fed. Reg. 59978 (July 24, 2024)] [hereinafter "RILA Form Adopting Release"], *available at* https://www.sec.gov/files/rules/final/2024/33-11294.pdf.[3]

2. **Rule 156**. As proposed, the SEC amended Rule 156 to cover RILA ads. By amending Rule 156, the SEC applied an antifraud rule applicable to investment company ads to RILAs to address when non-investment company ads are misleading under the federal securities laws. The amendments to Rule 156 became effective on September 23, 2024.

3. **Rule 482**. The SEC also proposed *not* to extend Rule 482 to RILAs. With one notable exception, RILA ads are subject to the prospectus delivery requirement, with the practical result that insurers cannot utilize broad-

[3] As proposed, the rule and form amendments were applicable only to RILAs, although the SEC requested comment on extending their scope to include registered market value adjustment annuities ("MVAs"). As adopted, the rule and form amendments apply to MVAs. While MVAs are not addressed herein, most, if not all, RILA advertising issues also pertain to MVAs.

based advertisements for these products. The author and her colleagues have described this approach as "unduly discriminatory against RILAs."[4] The SEC declined to accept industry comments, supporting its decision not to extend Rule 482 to marketing communications for RILAs with the following rationales:

- Funds and variable products are substantively regulated under the Investment Company Act of 1940 ("1940 Act"); insurance companies offering non-variable annuities, like other non-fund issuers, are not subject to substantive requirements and regulations under the 1940 Act.

- Rule 482 includes standards for using performance data in advertisements, and FINRA reviews fund performance advertisements according to specific rules and standards. FINRA does not currently have rules that expressly require similar standards for non-variable annuities.

- Congress expressly directed the SEC to adopt rules that permit registered investment companies to use prospectuses that include "information the substance of which is not included in the statutory prospectus," and that are deemed to be permitted by Section 10(b) of the Securities Act. Congress has not provided similar direction regarding non-variable annuities.

The author and her colleagues argue that the SEC's reasons for not amending Rule 482 do not withstand scrutiny.[5]

- While it is true that RILAs are not subject to substantive requirements and regulations under the 1940 Act, these products are subject to robust investor protections offered by comprehensive state regulation, and communications about RILAs are generally reviewed by FINRA, under a regime that has been in place since RILAs were first introduced.

- The fact that FINRA does not have performance standards for non-variable annuities should not preclude non-variable annuity issuers from taking advantage of the aspects of Rule 482 that are unrelated to performance.

[4] *See* T. Conner, H. Eisenstein, A. Furman, and W. Kotapish, *Rules for RILA and MVA Marketing Communications—Still Being Held Back, But There Remains a Crack in the Door*, The Investment Lawyer, Vol. 31, No. 9 (Sept. 1, 2024) [hereinafter "Rules for RILA Marketing Communications"].

[5] *See* Rules for RILA Marketing Communications, *supra* note 4.

- As to the absence of Congressional direction, it would be entirely appropriate and desirable for the SEC to amend Rule 482 to achieve comparable treatment of RILAs and variable annuities in order to avoid an unjustifiable preference of one type of well-regulated insurance product as compared with another.

4. **Rule 433**. Seasoned issuers and WKSIs eligible to file on Form S-3 are permitted by Rule 433(b)(1) under the Securities Act to use broad-based advertising without delivery of a prospectus. To maintain the *status quo* for RILA issuers moving to Form N-4, the SEC amended Rule 433 to explicitly cover RILA offerings that are registered on Form N-4 by issuers who file periodic reports pursuant to Section 15(d) of the Exchange Act. While thus maintaining the *status quo* for seasoned issuers, the SEC did not make clear the reasoning behind its determination to continue the unequal treatment of non-seasoned RILA issuers (relative to seasoned RILA issuers), which are prevented from using broad-based advertising for their RILA offerings.

D. Next Steps

1. **Amendments to Rule 482**. Notwithstanding its determination not to extend Rule 482 to RILAs, the SEC noted as follows: "Commenter suggestions that we amend rule 482 to include RILA advertising (so that all insurance companies would be permitted the ability to provide RILA sales literature to investors without being accompanied or preceded by a summary or statutory prospectus), subject to certain conditions, would benefit from further consideration, and the Commission invites further engagement on these issues."[6] For non-seasoned RILA issuers that do not file Exchange Act reports, the SEC's invitation for further engagement is a positive sign that signals the SEC's willingness to consider amendments to Rule 482 for all RILA issuers. In this regard, the SEC set forth factors for consideration in any future proposal regarding amendments to Rule 482, including:

   - the nature and scope of any applicable conditions,
   - the benefits of any such potential conditional expansion of Rule 482, and
   - the potential risk of misleading investors.

2. **Permit prospectus delivery by QR Code**. As part of an advertisement communicated by mass media it may be possible to include a Quick Response code ("QR code") that provides ready access to an issuer's website where a prospectus is available. On the website, an insurer could comply with the "sent or given" requirement by linking the Section 10 prospectus. The SEC has encouraged the use of QR codes in tailored

[6] RILA Form Adopting Release, *supra* p. 5, at 244.

shareholder reports and broker-dealer and investment adviser customer relationship summaries (Form CRS). As of the date of this paper, the SEC has not addressed the use of QR codes in RILA advertisements.

III. REGULATORY OBLIGATIONS WHEN USING GENERATIVE AI AND LARGE LANGUAGE MODELS

A. Introduction

1. **Regulatory Efforts**. SEC and FINRA regulation of AI involves many complex and unresolved issues that are well beyond the scope of this paper. For the SEC and FINRA, along with other federal and state regulators and the entities they regulate, AI regulatory issues are top of mind. Recent SEC and FINRA AI regulatory developments are discussed below.

2. **SEC Chief Artificial Intelligence Officer**. To support the responsible use of AI at the SEC, the SEC designated a senior leader to serve as the SEC's Chief Artificial Intelligence Officer ("CAIO"). The CAIO, in coordination with senior leaders across the SEC, is responsible for promoting AI innovation, managing AI risk, and implementing effective AI governance. The CAIO is also responsible for implementing OMB Memorandum 24-10, *Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence* (March 28, 2024), *available at* https://www.whitehouse.gov/wp-content/uploads/2024/03/M-24-10-Advancing-Governance-Innovation-and-Risk-Management-for-Agency-Use-of-Artificial-Intelligence.pdf. In accordance with OMB Memorandum 24-10, the CAIO has prepared and posted the SEC AI Compliance Plan (Sept. 2024), *available at* https://www.sec.gov/files/sec-ai-compliance-plan.pdf.

3. **FINRA Guidance**. For its part, FINRA has issued regulatory notices and investor alerts, and the FINRA Advertising Regulation Department has issued AI guidance in the form of FAQs. In addition, as discussed below, FINRA has identified AI as an emerging risk for member firms.

B. FINRA 2024 Regulatory Oversight Report

FINRA's annual regulatory oversight report (Jan. 2024) identified AI as an **emerging risk**, as follows:

- AI technology is rapidly evolving, most recently with the emergence of generative AI tools. As in other industries, broker-dealers and other financial services industry firms are exploring and deploying these technologies—either with in-house solutions or through third parties—to create operational efficiencies and better serve their customers. **While these**

tools may present promising opportunities, their development has been marked by concerns about accuracy, privacy, bias, and intellectual property, among others. As member firms continue to consider the use of new technologies, including generative AI tools, they should be mindful of how these technologies may implicate their regulatory obligations.

- The use of AI tools could **implicate virtually every aspect** of a member firm's regulatory obligations, and firms should consider these broad implications before deploying such technologies. Member firms may consider paying particular focus to the following areas when considering their use of AI:
  - Anti-Money Laundering
  - Books and Records
  - Business Continuity
  - Communications With the Public
  - Customer Information Protection
  - Cybersecurity
  - Model Risk Management (including testing, data integrity and governance, and explainability)
  - Research
  - SEC Regulation Best Interest
  - Supervision
  - Vendor Management

- In addition to existing rules and regulatory obligations, member firms should be mindful that the regulatory landscape may change as this area continues to develop. *See* https://www.finra.org/sites/default/files/2024-01/2024-annual-regulatory-oversight-report.pdf at p. 10.

C. AI and Large Language Models

1. **FINRA Enforcement Action**. In a recent enforcement action involving AML program failures wherein an algorithm incorporated a machine learning model to assign a score to each customer that helped determine how to evaluate the results of certain fraud checks, FINRA explained as follows: "Unlike traditional rules-based programming, machine learning models learn from input data to make predictions or identify meaningful patterns without being explicitly programmed to do so; as a result, they can be considered artificial intelligence technology." *Brex Treasury LLC*, FINRA AWC at n.3 (Aug. 30, 2024), *available at* https://www.finra.org/sites/default/files/fda_documents/2021071100401%20Brex%20Treasury%20LLC%20%20CRD%20299606%20AWC%20lp%20%282024-1727655599455%29.pdf (*citing FINRA, Report on Artificial Intelligence (AI) in the Securities Industry* at 2 (June 2020), *available at*

https://www.finra.org/rules-guidance/key-topics/fintech/report/artificial-intelligence-inthe-securities-industry).

2. **FINRA Regulatory Notice 24-09**. *FINRA Reminds Members of Obligations When Using Artificial Intelligence and Large Language Models* (Jun. 27, 2024), *available at* https://www.finra.org/sites/default/files/2024-06/regulatory-notice-24-09.pdf.

   a) RN 24-09 defines "artificial intelligence" as: "a wide-ranging term that generally means the capability of a machine to imitate intelligent human behavior. This term has been used to refer to a broad spectrum of technologies and applications, such as machine learning, deep learning, neural networks, and natural language processing (NLP)." *Citing* Sara Brown, *Machine Learning, Explained*, MIT Sloan School of Management (April 21, 2021).

   b) FINRA took the opportunity in RN 24-09 to remind firms of their AI regulatory obligations as follows: "As member firms incorporate the use of Gen AI or similar tools into their businesses, they should be mindful of the potential implications for their regulatory obligations. In addition, FINRA reminds its member firms that FINRA's rules–which are intended to be **technology neutral**–and the securities laws more generally, continue to apply when member firms use Gen AI or similar technologies in the course of their businesses, just as they apply when member firms use any other technology or tool."

   c) Further, FINRA explained: "AI technology has rapidly evolved in the 2020s, including the development and availability of Gen AI technology capable of generating significantly better text, synthetic data, images, or other media in response to prompts. [Large Language Models] LLMs are a type of Gen AI that use deep learning techniques and large data sets of language to identify, summarize, predict and generate new text-based content."

   d) Finally, in RN 24-09 FINRA invited engagement, as follows: "FINRA understands that this area is rapidly evolving, and member firms are continuing to consider Gen AI use cases. As they do so, FINRA stands ready to engage with member firms and other interested parties on the potential supervisory and compliance implication."

D. AI and Investment Fraud

1. On October 7, 2024, the SEC's Office of Investor Education and Advocacy (OIEA), together with the Commodity Futures Trading Commission's ("CFTC's") Office of Customer Education and Outreach, FINRA, the North American Securities Administrators Association ("NASAA"), the National Futures Association ("NFA"), and the Securities Investor Protection Corporation ("SIPC"), issued an Investor Bulletin entitled *Technology and Digital Finance: World Investor Week 2024*, that addresses technology and investment fraud ("Technology and Digital Finance"), *available at* https://www.finra.org/investors/insights/world-investor-week-2024.

2. The Technology and Digital Finance Investor Bulletin notes as follows:

> "Emerging technologies like artificial intelligence and crypto assets, and digital platforms like social media and mobile trading apps, are increasingly influencing how people invest. As you navigate the world of digital investing, it's important to understand how bad actors might exploit these technologies to conduct investment scams. It also remains important to do your own research and make investment decisions with your long-term investment plan in mind.
>
> . . . Bad actors use the hype around new technological developments, like artificial intelligence (AI) and crypto assets, to lure investors into scams. They might use catchy buzzwords or claim to be a leader in an emerging technology.
>
> Scammers can use AI technology to clone voices, alter images and create fake videos to spread false or misleading information. They might use AI-generated content to impersonate someone you know or create realistic looking websites promoting fake investments."

3. On January 25, 2024, the SEC OIEA , the NASAA, and FINRA issued an investor alert entitled *Artificial Intelligence and Investment Fraud*, which was designed to make investors aware of the increase of investment frauds involving the purported use of AI and other emerging technologies ("AI Fraud Investor Alert"), *available at* https://www.finra.org/investors/insights/artificial-intelligence-and-investment-fraud.

4. The AI Fraud Investor Alert identified and discussed points for investors to look out for to avoid AI frauds, including:

   - unregistered/unlicensed investment platforms claiming to use AI;
   - investing in companies involved in AI; and
   - AI-enabled technology used to scam investors, including "deepfake" video and audio.

E. AI Created Communications and Chatbot Communications

1. **Overview.** In 2024, FINRA's Advertising Regulation Department published FINRA Rule 2210 interpretive guidance (in the form of two FAQs) regarding review and supervision of communications created using AI and chatbot communications. In this regard, FINRA noted that the FAQs are "not intended to provide an exhaustive list of obligations that may apply. For example, if a broker-dealer uses AI technology to make a recommendation of a securities transaction, or an investment strategy involving securities (including an account recommendation), to a retail customer, then Regulation Best Interest would apply. See Exchange Act Rule 15*l*-1." The FAQs follow and are *available at* https://www.finra.org/rules-guidance/guidance/faqs/advertising-regulation#d8.

2. **D.8.1. Q: Is a firm responsible for the content of communications created using artificial intelligence (AI) technology**?

   A. Yes. Firms are responsible for their communications, regardless of whether they are generated by a human or AI technology. Accordingly, firms must ensure that AI-generated communications they distribute or make available comply with applicable federal securities laws and regulations and FINRA rules. This obligation includes compliance with supervision requirements, applicable FINRA and SEC recordkeeping requirements, as well as the applicable content standards in FINRA Rules 2210 and 2220 (and for Funding Portals, Rule 200(c)). These content standards generally require that communications be fair and balanced and prohibit the inclusion of false, misleading, promissory or exaggerated statements or claims. (Footnote omitted.)

3. **B.4.1. Q. If a firm uses AI technology to create chatbot communications that are used with investors, how should the firm supervise that activity**?

   A. Depending on the nature and number of persons receiving the chatbot communications, they may be subject to FINRA communications rules as correspondence, retail communications, or institutional communications. Therefore, the firm must supervise the chatbot communications in accordance with applicable FINRA rules. See FINRA Rules 2210(a), 2210(b), and 3110(b)(4) and 3110.06 through .09. Among other things, Rule 3110(b)(4) requires firms to establish, maintain, and enforce written procedures for the review of incoming and outgoing written (including electronic) correspondence relating to the firm's investment banking or securities business that must be appropriate for the member's business, size, structure, and customers. In addition, the content must be consistent with

applicable standards, such as those in FINRA Rule 2210(d). (Footnotes omitted.)

IV. SOCIAL MEDIA INFLUENCERS – aka FINFLUENCERS

A. Background

1. In April 2017, FINRA provided guidance regarding the application of FINRA rules governing communications with the public to digital communications, in light of emerging technologies and communications innovations. *Social Media and Digital Communications*, FINRA Regulatory Notice 17-18 (Apr. 27, 2017), *available at* https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-18.pdf.

2. Among other topics, RN 17-18 addressed testimonials and endorsements, as follows:

> **Q9: A third party may post unsolicited favorable comments about a registered representative on the representative's business-use social media website. The representative may then like or share the comments. Under these circumstances, are the third-party comments deemed to be a communication of the representative and, therefore, subject to FINRA's communications rules?**
>
> A: By liking or sharing the favorable comments, the representative has adopted them and they are subject to the communications rules, including the prohibition on misleading or incomplete statements or claims, the testimonial requirements noted above, and the supervision and recordkeeping rules. (Footnote omitted.)

B. FINRA Finfluencer Sweep

1. **Targeted Exam Letter**. To gain a better understanding of firm practices related to acquisition of customers through social media channels, FINRA conducted a targeted examination (finfluencer sweep), commending in September 2021. Social Media Influencers, Customer Acquisition, and Related Information Protection (Sept. 2021), *available at* https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/social-media-influencers-customer-acquisition-related-information-protection. Through the targeted sweep, FINRA sought information on how firms manage their regulatory obligations, including those related to information collected from customers acquired through social media channels.

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 collection of so-called "cookies" obtained from customers or individuals who provide non-public information ("NPI") 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: Privacy of Consumer Financial Information and Safeguarding Personal Information, such as written supervisory procedures, privacy notices, and opt-out notices.

2. **FINRA Update on Finfluencer Sweep**. In February 2023, FINRA provided an update on the finfluencer sweep. *See* Social Media Influencers, Customer Acquisition and Related Information Protection (Feb. 2023), *available at* https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/sweep-update-feb2023. 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.

FINRA's 2023 finfluencer sweep 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 NPI with non-affiliated third parties.

C. FINRA Finfluencer Enforcement Actions

1. **Overview.** Thus far in 2024, FINRA has settled three finfluencer-related enforcement actions (on March 15, April 3, and June 10). The settled actions are similar in findings and alleged violations. FINRA alleges in each action that social media influencer posts were not fair or balanced and/or were promissory. FINRA also alleges that each firm did not review or approve the content of influencer posts or retain influencer communications or have a reasonable system in place for supervising influencer communications. The June 10, 2024, action also alleges violations of SEC Regulation S-P relating to inaccurate privacy notices and sharing NPI (including customer names, e-mail addresses, social security numbers, birthdates, and state IDs) with non-affiliated third parties for marketing purposes.

2. **M1 Finance LLC**. FINRA AWC (Mar. 15, 2024), *available at* https://www.finra.org/sites/default/files/2024-03/m1_awc_no_20210725811.pdf. According to this AWC:

   a) M1 Finance provides self-directed trading to retail investors through its mobile application and website. FINRA found as follows:

      (1) M1 Finance's influencers posted on the firm's behalf communications about the firm that were not fair and balanced or made claims that were exaggerated, unwarranted, promissory, or misleading.

      (2) M1 Finance did not have an appropriately qualified registered principal review its influencers' posts prior to them being made public. During that period, the firm also did not maintain records of the retail communications created by its influencers or the date each retail communication was used.

      (3) During the relevant period, M1 Finance did not establish, maintain, or enforce a reasonably designed supervisory system, including WSPs, for the firm's retail communications posted by the firm's influencers.

      (4) As a result, FINRA determined that M1 Finance violated FINRA Rules 2210(d)(1), 2210(b), 4511, 3110, and 2010 as well as Section 17(a) of the Exchange Act and Rule 17a-4 thereunder. Without admitting or denying FINRA's findings, M1 Finance agreed to a censure and fine of $850,000.

   b) "As investors increasingly use social media to inform their financial decisions, FINRA's rules on communicating with the public are especially critical. 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," Bill St. Louis, Executive Vice President, and Head of Enforcement, FINRA. *FINRA Fines M1 Finance $850,000 for Violations Regarding Use of Social Media Influencer Program*, FINRA Press Release (Mar. 18, 2024), *available at* https://www.finra.org/media-center/newsreleases/2024/finra-fines-m1-finance-850000-violations-regarding-use-social-media.

3. **Cobra Trading Inc**. FINRA AWC (Apr. 3, 2024), *available at* https://www.finra.org/sites/default/files/fda_documents/2021072501001%20Cobra%20Trading%2C%20Inc.%20CRD%20132078%20AWC%20gg.pdf. According to this AWC:

a) Cobra Trading Inc. provides self-directed trading to retail investors through its online portal. FINRA found as follows:

(1) Cobra Trading paid influencers with followings on social media sites to promote the firm in social media communications. The influencers posted on the firm's behalf communications about the firm on social media sites that were not fair and balanced or made claims that were promissory.

(2) Cobra Trading did not review these influencers' videos prior to their posting on social media platforms, nor did the firm retain those videos. Cobra Trading also failed to establish, maintain, and enforce a system, including WSPs, reasonably designed to supervise communications disseminated on the firm's behalf by influencers.

(3) As a result, FINRA determined that Cobra Trading violated FINRA Rules 2210(d)(1), 2210(b), 4511, 3110, and 2010 as well as Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder. Without admitting or denying the findings, Cobra Trading consented to a censure and a fine of $200,000.

4. **TradeZero America, Inc**. FINRA AWC (June 10, 2024), *available at* https://www.finra.org/sites/default/files/fda_documents/2021072501001%20Cobra%20Trading%2C%20Inc.%20CRD%20132078%20AWC%20gg.pdf. According to this AWC:

a) TradeZero America provides self-directed trading to retail investors through its online portal. FINRA found as follows:

(1) Trade Zero America paid influencers who posted social media communications on the firm's behalf that were not fair and balanced or that made exaggerated or promissory claims. TradeZero America did not review its influencers' videos prior to their posting on social media platfo1ms, nor did the firm retain those videos. The firm also did not review or retain influencers' posts made in online interactive electronic forums. TradeZero America also failed to establish, maintain, and enforce a system, including WSPs, reasonably designed to supervise retail communications disseminated on the firm's behalf by its influencers.

(2) In addition, TradeZero America provided customers with privacy notices that inaccurately stated the extent to which the firm would use their nonpublic personal information.

(3) As a result, FINRA determined that TradeZero America violated FINRA Rules 2210(d)(l), 2210(b), 4511, 3110, and 2010 as well as Section 17(a) of the Exchange Act and Rule l7a-4(b)(4) thereunder and Regulation S-P of the Exchange Act (Rule 4). Without admitting or denying FINRA's findings, TradeZero America consented to a censure and $250,000 fine.

D. SEC Finfluencer Enforcement Action

1. **In the Matter of VanEck Associates Corporation**. Order Instituting Administrative and Cease-and-Desist Proceedings, Investment Company Act Release No. 35132, Investment Advisers Act Release No. 6560 (Feb. 16, 2024), *available at* https://www.sec.gov/files/litigation/admin/2024/ic-35132.pdf.

   a) 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 ETF. The SEC's complaint alleges that the influencer's involvement and details of an anticipated licensing arrangement were not initially 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 1940 Act and Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act"). The SEC censured the adviser and imposed a fine of $1.75 million.

   b) Without admitting or denying the SEC's findings, VanEck Associates consented to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 9(f) of the 1940 Act and Sections 203(e) and 203(k) of the Advisers Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order. The SEC censured VanEck Associates and imposed a fine of $1.75 million.

E. FINRA Finfluencer Podcast

1. On June 25, 2024, FINRA Advertising Regulation published a podcast entitled *Finfluencers: New Marketing Strategies Meet Existing Compliance Obligations*, *available at* https://www.finra.org/media-center/finra-unscripted/finfluencer-social-media-targeted-review.

2. The podcast examined the results of the finfluencer targeted review, the risks and regulatory requirements around this form of advertising and shared some best practices for firms looking to make use of social media influencer programs.

F. Gen Z and Investing

1. In May 2023, the FINRA Investor Education Foundation and CFA Institute issued a research brief on Gen Z and investing entitled *Gen Z and Investing: Social Media, Crypto, FOMO, and Family* (May 2023). https://www.finrafoundation.org/sites/finrafoundation/files/Gen-Z-and-Investing.pdf.

2. Gen Z is defined as those born between 1997 and 2012, however, the FINRA study sampled only those ages 18 to 25. With regard to social media influencers, the study noted as follows: "With many resources at their disposal, Gen Z investors learn about investing and finances primarily through social media (48 percent), internet searches (47 percent), parents/family (45 percent), and friends (40 percent)."

V. FINRA BRANCH OFFICE REGISTRATION, NON-BRANCH LOCTIONS, DESIGNATION, AND INSPECTION

A. Introduction

On January 23, 2024, FINRA adopted FINRA Rule 3110.19 (Residential Supervisory Location) and FINRA Rule 3110.18 (Remote Inspections Pilot Program), and announced the end of temporary relief related to updates of office information on Form U4 and Form BR. *See* FINRA Regulatory Notice 24-02 (Jan. 23, 2024), *available at* https://www.finra.org/rules-guidance/notices/24-02.

B. Residential Supervisory Locations ("RSLs")

1. **FINRA Rule 3110.19** treats a private residence at which an associated person engages in specified supervisory activities, subject to certain safeguards and limitations, as a **non-branch location**. As a non-branch location, an RSL is subject to inspections on a regular periodic schedule (presumed to be at least every three years) instead of the annual inspections currently required for an office of supervisory jurisdiction ("OSJ") and "supervisory branch office."

2. To use this RSL designation under Rule 3110.19, a firm and the associated person at each location must meet **specified conditions and eligibility requirements**. Among other requirements, a firm must conduct and document a risk assessment and **provide a list of RSLs to FINRA** on a

periodic basis (*i.e.,* by the 15th day of the month following each calendar quarter) in the manner and format FINRA has prescribed.

3. FINRA reminded firms in RN 24-02 that they should consider whether any potential increase in the number of offices or locations may implicate Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations), which requires a firm to seek FINRA's approval for a "material change in business operations," or IM-1011-1 (Safe Harbor for Business Expansions). As a result of RN 24-02, firms were required to review their FINRA membership agreement to determine whether an increase in its number of offices or locations was a material change in business operations, and, if necessary, seek guidance from FINRA's MAP Group through the materiality consultation process.

4. On September 16, 2024, FINRA announced a new question on Form U4 to identify RSLs. FINRA explained as follows: "Firms that have identified a location as a non-registered private residence are required to answer the RSL Question as either "Yes" or "No" by December 26, 2024. The previously announced October 15, 2024, date in Regulatory Notice 24-02 has been replaced by the December 26, 2024 deadline." *Available at* https://www.finra.org/rules-guidance/key-topics/residential-supervisory-locations/new-question-u4-identify-rsl.

5. As of the date of this paper, the New York Stock Exchange ("NYSE") and certain states had not adopted the RSL designation. In response, on October 7, 2024, FINRA announced enhancements to Form BR (Uniform Branch Office Registration Form) for amendments to Form BR submissions for existing locations that will allow firms to account for the RSL designation by de-selecting a location's registration for FINRA and the jurisdiction that accepts the RSL designation, while continuing to pre-select the location's registration or "notice filing" in a jurisdiction or the NYSE, or both, that has not accepted the RSL designation. *Available at* https://www.finra.org/rules-guidance/key-topics/residential-supervisory-locations/form-br-enhancements-rsl-faqs.

6. In addition to the foregoing, FINRA has issued FAQ guidance about RSLs, including the following:

Q1: What is a Residential Supervisory Location?

A1: In general, a Residential Supervisory Location (RSL) is **a private residence** from which an associated person **engages in supervisory functions**, including those described in FINRA Rule 3110(f)(1)(D), (E), (F) and (G), and FINRA Rule 3110(f)(2)(B). **An RSL is a non-branch location** (*i.e.*, an unregistered office or non-registered location), which means that a firm does not need to register it as a branch office under Article IV, Section

8 of the FINRA By-Laws. As a non-branch location, a firm is required to inspect an RSL on a regular periodic schedule, presumed to be at least every three years, in accordance with FINRA Rule 3110(c)(1)(C) and FINRA Rule 3110.13. Prior to designating an office or location as an RSL, a firm must develop a reasonable risk-based approach to designating such office or location as an RSL and conduct and document a risk assessment for the associated person assigned to that office or location, *available at* https://www.finra.org/rules-guidance/key-topics/residential-supervisory-locations/faq#u4.

Q8: Does a firm have to register an RSL on Form BR with FINRA?

A8: No. As a non-branch location (i.e., unregistered office or non-registered location), an RSL need not be "registered" on Form BR as a branch office with FINRA. However, as noted in the FAQs below, NYSE and some jurisdictions do not currently accept the RSL designation, in which case the firm would need to register or "notice file" the location in that particular jurisdiction or with the NYSE, or both, as applicable, as a branch office.

Also, FINRA reminds firms that they will be required to update an individual's Form U4 to provide FINRA with the individual's current Office of Employment (OEA) (both registered and unregistered, as applicable) and provide RSL information in accordance with Rule 3110.19(d). As explained in Q15.2/A15.2, starting on September 14, 2024, Form U4 includes a new question eliciting information to identify locations as RSLs. *Id.* at Q8.

Q14: Can the "Supervised From" location identified on the Form U4 be an RSL?

A14: No. The "Supervised From" location must be the office to which the supervisor is assigned. For some firms, such office may be the main office. *Id.* at Q14.

C. Remote Inspections Pilot Program ("Pilot Program")

1. **FINRA Rule 3110.18** established a voluntary, three-year remote inspections Pilot Program to allow eligible member firms to fulfill their Rule 3110(c)(1) **inspection obligation** of qualified branch offices, including OSJs and non-branch locations **remotely**, without an on-site visit to such offices or locations, subject to specified terms.

2. Under FINRA Rule 3110.18(i), a firm must **affirmatively elect to participate** in the Pilot Program by providing FINRA with an "opt-in notice" and once enrolled, must affirmatively elect to withdraw from the Pilot Program by providing FINRA with an "opt-out notice," in the form and manner prescribed by FINRA. FINRA developed a technological

process in FINRA Gateway through which firms are able to provide FINRA the requisite notices electronically, in an efficient manner. FINRA announced on July 24, that 741 firms elected to participate in the Pilot Program, representing 22% of FINRA firms. *See* https://www.finra.org/media-center/newsreleases/2024/finras-remote-inspections-pilot-program-begins.

3. Pilot Program participants must conduct and document a risk assessment for that office or location. In addition, Pilot Program participants must revise their WSPs to address several areas. *See* https://www.finra.org/rules-guidance/key-topics/remote-inspections-pilot-program.

4. Pilot Program participants also are required to provide FINRA with specified data and information. For Pilot Program participants, FINRA published the following "findings reporting categories":

1. Supervision of Supervisory Personnel and Potential Conflicts of Interests
2. Sales Practices/Business Conduct
3. Control of Non-Public Information and Reg S-P Issues
4. Customer Account Changes
5. Supervisory Deficiencies Relating to the Preparation and/or Distribution of Consolidated Account Reports
6. Other Books and Records
7. Branch Correspondence and Internal Communications
8. Advertising and Sales Material
9. Off-Channel Communications
10. Customer Complaints
11. Safeguarding and Handling of Customer Funds and Securities/ Transmittals
12. OBAs/PSTs
13. Cybersecurity
14. Other

See https://www.finra.org/sites/default/files/2024-09/3110.18-Findings-Reporting-Categories.pdf.

5. An eligible firm that did not elect to join Pilot Year 1 between June 1, 2024, through June 26, 2024, may choose to join the Pilot Program in accordance with the requirements of Rule 3110.18(i) for **a subsequent Pilot Year** on or before these dates:

December 27, 2024, to join Pilot Year 2 (Jan. 1, 2025, to Dec. 31, 2025);
December 27, 2025, to join Pilot Year 3 (Jan. 1, 2026, to Dec. 31, 2026); and
December 27, 2026, to join Pilot Year 4 (Jan. 1, 2027, to June 30, 2027).

D. Non-Branch Residential Locations

1. Forms U4 and BR are required to reflect current registration and address information for each office or location. As non-branch locations, RSLs and residential locations not engaged in supervision activities are not required to be listed on Form BR but are required to be identified on Form U4.

2. Non-branch locations – both RSL and non-RSL – are subject to inspections on a regular periodic schedule (presumed to be at least every three years).

3. FINRA Rule 3110 identifies other types of non-branch locations that may apply to a hybrid work arrangement. The following FAQ explains as follows:

   Q19: In addition to the RSL, what other types of non-branch locations may apply to a hybrid work arrangement?

   A19: Rule 3110(f)(2)(A) sets forth several locations that are excluded from the "branch office" definition. These locations, if they meet specified conditions, are viewed as non-branch locations because they are "unregistered" offices (i.e., non-registered locations). These non-branch locations include, among others, a "non-sales" or "back office" location (Rule 3110(f)(2)(A)(i)); a "primary residence" (Rule 3110(f)(2)(A)(ii)); and a location other than a primary residence (i.e., "non-primary residence") (Rule 3110(f)(2)(A)(iii)), *available at* https://www.finra.org/rules-guidance/key-topics/residential-supervisory-locations/faq.

4. FINRA has provided guidance on completing Form U4 when broker-dealer personnel work from more than one location as follows:

   Q11: My firm will have associated persons working from multiple locations. Does Form U4 permit multiple address entries?

   A11: Yes. Section 1 (General Information) of Form U4 allows for multiple office of employment addresses to be entered on the form. Using FINRA Gateway, addresses are entered by selecting "Add Registered Office of Employment Address" or "Add Non-Registered Office of Employment Address," found within the "Office of Employment Address" section of "Registration Requests with Firms."

   Q12: If an associated person works from a branch office three days a week and a private residence two days a week on a regular schedule, is there an expectation that a firm must now capture on the Form U4 two OEAs—one for the branch office and the other for the private residence?

   A12: Yes. If the physical office or location of a registered person meets the definition of an OSJ, branch office or an applicable exclusion from

registration, it must be reflected on the individual's Form U4. If the registered person's physical location is at a branch office and at a private residence, both addresses must be listed as an OEA. Form U4 allows for multiple address entries. *Id.*

E. "Material Change in Business Operations"

1. Depending on the number of branch and non-branch locations that a firm needs to add, it may or may not satisfy the safe harbor for business expansions. If the additional offices would exceed the number of authorized branch and non-branch locations set forth in a firm's FINRA membership agreement, a firm may need to seek a materiality consultation and/or submit a continuing membership application ("CMA") for authorization to add additional offices.

2. FINRA addressed this issue in FAQ guidance as follows:

Q31: My firm estimates that the number of OSJs, branch offices, and non-branch locations (e.g., RSLs, primary residences, back office/non-sales locations) it is planning to designate, will result in an increase in the total number of firm offices (registered and unregistered) that will be above the office count specified in the firm's membership agreement and the thresholds set forth in IM-1011-1 (Safe Harbor for Business Expansions) ("Safe Harbor"). The firm will comply with the definitions of OSJ and branch office, including the exclusions, and the conditions of Rule 3110.19 in establishing RSLs. Other than providing a "second seat" to associated persons at eligible locations, the firm will not be undergoing any other changes in business operations. The firm does not have any written restrictions on the number of offices (registered and unregistered) it is permitted to have under the firm's Membership Agreement. Because the office count (registered and unregistered) will exceed the Safe Harbor, would the firm need to file a Continuing Membership Application (CMA) under paragraph (a)(5) of Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations) seeking FINRA's approval of the increased office count?

A31: The firm must determine if the change is material in accordance with Rule 1017. For example, where the firm is only adding "second seats" for its associated persons at eligible locations, the firm should review the relevant facts and circumstances, including the degree to which the firm's existing supervisory and compliance systems can accommodate a more dispersed workforce, and should determine whether the contemplated increase in the number of offices (both registered and unregistered) will be a "material change in business operations" for the firm such that it would

trigger the need to file a CMA. Based on a reasonable review, a firm may be able to conclude that the contemplated increase is not material. As part of the firm's own "materiality" determination for purposes of compliance with Rule 1017, the firm must document its determination and the factors it reasonably considered in making such determination, including, at a minimum:

- The counts by office type—OSJ, non-OSJ branch office and non-branch location, specifying the RSLs established in accordance with Rule 3110.19 and the other non-branch locations under Rule 3110(f)(2)(A); and
- The relevant facts and circumstances the firm considered in determining the increased office count is not a "material change in business operations."

It may be worthwhile for the firm to review note [sic] that Notice to Members 00-73, discusses, facts and circumstances to consider when a firm assesses the materiality of a change. *Id.*

3. Thus, FINRA has determined that, if the firm is only adding "second seats" for its associated persons at eligible locations and, "based on the firm's review of the relevant facts and circumstances, including the degree to which the firm's existing supervisory and compliance systems can accommodate a more dispersed workforce, then the firm may be able, based upon a reasonable review of the relevant facts and circumstances, to determine that the contemplated increase in the number of offices may not be a 'material change in business operations' that would trigger the need to file a CMA." *Id*.

VI. CONCLUSION

This paper addresses the status of four important SEC and FINRA regulatory issues as of October 2024. While the SEC's July 1, 2024, amendments to Securities Act advertising rules did not provide the result commenters had requested, work to level the advertising playing field among RILA issuers and between RILA issuers and variable annuity issuers will continue considering the SEC's invitation to further engage on these issues. Further, FINRA's 2024 guidance and enforcement actions regarding finfluencer communications, AI, and non-branch location inspection issues are signs of the times as technology continues to develop, and broker-dealer personnel continue to work from more than one location.

A.B.F.
10/21/24